The Claim Has Landed, Now What?

by Joel W. Meskin, Esq., CIRMS w Featured in *Community Interests*, April 2010

It was 9:30 pm and the finale of American Idol was coming to its crescendo. Seaview Condominium President Joan Smith's doorbell rang. Ms. Smith opened her door to find a county sheriff standing there and her heart dropped as her husband had been out with his friends at a ball game. Upon confirmation of Joan's name, the sheriff said, you are served with a summons and compliant. The lawsuit was 50 pages long and almost as entertaining as a National Enquirer article. After spending the next hour reading frivolous and outrageous allegations of breach of fiduciary duties, fraud, mismanagement, defamation, emotional distress and bodily injury claims, Ms. Smith sat back with her jaw on the floor not knowing what to do and considering curling up into a fetal position in the corner of her balcony. She joined the board because she wanted to give back to the building that had been a wonderful place for her and her husband for the past 10 years as they were enjoying retirement. She now regretted her decision.

When Mr. Smith got home, he was furious and incredulous. He immediately called his son who was a new attorney and had been hired by the biggest and highest profile firm in town. The firm agreed to handle the matter for 50% off its standard fee. Sonny Smith immediately got to work and reviewed the lawsuit. He interviewed all the board members and the property manager, all who were named in the lawsuit. He filed motions to dismiss; he filed demurrers and motions to strike and finally filed an answer. Sonny began the discovery process and noticed depositions of the plaintiffs. Sonny served and responded to written discovery. Sonny researched all appropriate points of law and finally filed a motion for summary judgment.

During the six months that Sonny Smith was vigorously defending the lawsuit, Seaview's board changed insurance carriers, because they got a better price, a lower deductible, and higher limits. The motion for summary judgment was denied. Accordingly, a trial date and settlement conference were both scheduled. Sonny asked his parents for the name of the insurance carrier so he could request that they attend the settlement conference. Sonny reviewed the policy of insurance in effect when the lawsuit was filed and saw it provided for defense fees and costs. He submitted a demand that his $45,000 in attorney's fees (a bargain at a 50% discount) be reimbursed to the association and that the insurance company attend the settlement conference.

Ms. Smith received a phone call from the association's insurance agent saying that the Directors and Officers insurance carrier on the risk at the time was filed, denied coverage and that the new D&O carrier denied coverage. Moreover, the general liability carrier was denying coverage for any of the pre-notice defense fees and costs and was reserving its rights to deny coverage for many reasons including late notice, and the fact that the board members were not included within the definition of insureds.

The good news for Ms. Smith is that her son made his new firm a lot of money. The bad news is that the firm was requiring payment of the outstanding $45,000 bill and a retainer of $20,000 to continue moving forward. Since the association by-laws do not allow the use of reserve funds for this type of expense, the Seaview board had to issue a $650 special assessment to each of the 100 unit owners ($450 for the bill and $250 for the retainer).

Ms. Smith's presidency is being challenged. Not only

is it being challenged, a group of association members are threatening to sue Ms. Smith and the board for breach of fiduciary duty for not submitting this to the insurance carrier and for the conflict of interest of hiring her son who had no community association experience and for not seeking out council that did. Needless to say, Ms. Smith is having a "no good, very bad, horrible rotten day."

Most individuals and families choose to live in a common interest development thinking that the maintenance of their physical and social environment will be substantially taken care of for them. No matter how well a community is managed, as sure as there is death and taxes, at some point there will be an incident that will give rise to a lawsuit or claim requiring the association to respond. This reality gives rise to the necessary evil of insurance. In a perfect world, upon the happening of such an incident, the association representative would make a single phone call to the insurance company, provide the requested information and the insurer would immediately make a direct deposit for the claim into the association's account or arrange any other requested solution or remediation. In that world, Ms. Smith would have been able to sleep well after being served with the lawsuit.

In the real world, the process is not always that simple. However, it does not have to be as complicated or as frustrating as it often is. The fortunate fact is that most associations do not have claims on a regular basis. The consequence of this, however, is that most associations are not adequately experienced in the claim's process and many do not have or do not think to seek assistance from professionals who are experienced in claims handling. Most frustration is the result of a lack of knowledge of the various insurance products compounded with weak communication between the board member/insured and the insurance carrier representatives.

Contrary to the belief of many board member/insureds, most insurance companies do not sit back and try to figure out ways to deny claims. The adjuster's favorite word is not "denied." Insurance companies are in business to make money and if they do not have satisfied customers, they do not sell insurance. Yes, insurance carriers work hard to minimize losses, but insurance is priced to contemplate losses. If there were never losses, there would never be a need for insurance in the first place. If you ask most claim professionals, there is nothing they like better than to receive a claim or loss submission that first within the parameters of coverage and is properly documented. That would allow the adjuster to pay, making the insured happy. A great deal of frustration by board member/insureds emanates from their not understanding that the claims adjuster has a job to do, procedures to follow, and is accountable for their decisions.

What insureds must keep in mind during the claim process is that not every potential risk is covered by insurance. This is generally the result of one of two factors: (1) the risk is not insurable (such as normal wear and tear of an association's property); and (2) the insured made an economic decision not to purchase all of the broadest available coverage – the price factor (specifically, not all insurance products are created equal).

That having been said, this article focuses on what to do when a loss occurs or a claim is received. Specifically, the focus will be on:
The most common mistakes boards, associations, or their representatives make when submitting or handling a claim.
Key advice for boards, associations, or their representatives for smooth and effective submission and handling of a claim.
Recommendations for claims prevention.

What plans an association should have in place pre-claim to make the inevitable claim situation smoother and more expeditious.

THE MOST COMMON MISTAKES ASSOCIATIONS MAKE WHEN SUBMITTING OR HANDLING A CLAIM

One of the nice things about other people's mistakes is that the rest of us can learn from them more cheaply than as if we had made the mistake ourselves. The community association professionals contacted for this article have identified the following common mistakes.

Notice

The number one identified mistake exemplified above, which includes numerous issues, revolves around giving notice of a claim, occurrence or loss. The origin of this "critical" mistake is based in the insured's lack of experience. What often happens is that when an inexperienced board member is served with a summons and compliant they immediately contact the first attorney that comes to mind as Ms. Smith did above. This is often a relative or friend. With the best of intentions (in most cases), that relative or friend reviews the matter and makes recommendations on how the individual should respond from a "legal standpoint." What is not taken into consideration in many cases in the "insurance factor." The following are some of the key "notice" issues:

Forgetting to Notify All Carriers

Most associations have numerous components to their insurance program. Sometimes the insured, its management, or a broker do not place all carriers for the association on notice because they do not believe there is coverage, or they do not think that a certain policy may in fact provide coverage. They may notify the directors and officers liability carrier, but not the general liability carrier. Some prescribe to the philosophy of "shot gun" notice where all carriers, no matter how improbable coverage, should be put on notice and let the carriers make the coverage decisions. Others opine that the submission should be somewhat more surgical.

Not Understanding Pre-Notice Issues

As I am drafting this portion of the article, I received notice of a claim for a broker. In the notice, the broker indicates "that the insured would like to have its own counsel, because that counsel has been working on pre-suit issues involving the claim." This in and of itself may raise issues as to why notice was not previously given. Were these "facts and circumstances" that an insured believes could reasonably give rise to a "claim?" One huge consequential issue that may arise is who is responsible for pre-notice attorney fees and costs as Ms. Smith found out the hard way.

Not Understanding Notice and Reporting Requirements

Many boards and their representatives do not understand the reporting requirements under the various insurance policies and consequently may fail to satisfy them. Many times a policy requires notice to the carrier of a claim or potential claim, not just after a lawsuit has been served. Boards/management need to be familiar with the policy requirements as to what is a "claim" and what is "notice." Specifically, these items should be understood when the policy is first delivered and not when the claim or other occurrence happens. This should be on the list of questions to ask your agent. In our example above, had Sonny Smith advised the association's carriers immediately, the entire $45,000 would have been paid, or at a minimum, the defense fees and costs of a law firm appointed to defend Seaview and Ms. Smith would have been paid and possibly resolved the matter expeditiously based on its community association experience.

Failure to Follow-Up

Although most of us brokers never make errors or forget things (tongue in cheek), it is prudent to follow up to make sure the insurance broker actually notified the insurance carrier. The board will ask the management to put carriers on notice and management will telephone or email the insurance broker. However, a written response by the broker as well as making sure the carrier acknowledges the claim filing is important. This is not a time where ignorance is bliss.

Untimely Reporting

The consequences of not submitting a matter in a timely manner has a number of potential negative consequences. Unfortunately, people always think it will work its way out. However, in life that seems to only apply to the other guy. Different states treat late notice differently; some require that a carrier be prejudiced. The timeliness issue also takes on different consequences depending on the type of loss or claim that is being contemplated. For example, "property" loss claims require active steps by insureds to "mitigate" damages and to prevent the exacerbation of a loss. This is particularly the case in water damage claims where notorious and infamous "mold" potentially lurks in any such claim.

Poor Communication

The failure to communicate, as my wife often tells me, is the root of many problems. In the claim context, this failure takes on many shapes and sizes.

First, many associations approach the claim situation as an "adversarial" process and only provide that information they think the carrier needs to know requiring the carrier to come back multiple times with additional follow-up questions.

Second, associations do not designate a single person to be the liaison for the associations regarding a claim: "too many cooks in the kitchen." Accordingly, there is inconsistent and incomplete information being provided.

Third, associations hold back information thinking that it may have a negative impact on coverage. The reality is that what will be, will be and that the association should err on the side of providing information and let the carrier determine what is or is not needed.

Fourth, there is often a dropped ball when boards change or property management companies or employees change.

Weak Documentation

The failure to properly document a loss or to keep records of what has happened is a critical flaw in the resolution of many claims.

The document process for associations must start far in advance of any claim. The associations often do not have any procedures or protocols for pre- or post-claim situations.

Associations and mangers often do not thoroughly record or memorialize claim information claim information or relevant facts and circumstances.

The key requirement of a claim representative is to document his or her file. The source of those documents is the insureds. This is one of those situations where all the insureds need to do is put themselves in the place of the adjuster: would they write a check for something based on the information they have provided is it was coming out of their pocket?

Although it may sound obvious, many associations and their agents or representatives fail to take pictures of damages and other physical evidence of a claim. This would also include videotaping of various situations if appropriate. We all know that "a picture tells a thousand words." It is also imperative that the association documents who took the pictures, when and who else was present at the time. For example what is more telling: the statement that the building was damaged or the picture showing the damage?

Failure to Understand Choice of Counsel

The counsel issue is multi-faceted.

Many associations are small or self-managed and do not actually have counsel, probably because they have not had occasion to need counsel. (Remember that there is a substantial number of small self-managed associations around the country) Accordingly, when a claim comes in, many times a board member will call the first attorney he or she knows (we have all received those phone calls), or the attorney that they have used in their non-association business. Selecting counsel that is not versed in Community Association law and insurance is potentially a huge mistake.

Sometimes, the association has counsel that handles its affairs on a general corporate basis. These attorneys may not be familiar with claims and/or litigation issues. Just because the attorney does not work for the association does not mean that the association's counsel is the correct one to handle the claim. There could be issues regarding the requirement to use an insurer's panel counsel. Sometimes counsel will hold onto and work on a matter prior to submitting it to the carrier possibly exposing the insured to attorney fees and costs that may not be reimbursable pursuant to the terms and conditions of the policy. There are also potential conflicts of interest issues.

The choice of counsel is an issue that it hotly disputed by many attorneys. Many attorneys are of the opinion that they know the association, they know the players and they can resolve issues much more expeditiously. This if often true, and I believe that most carriers are willing to entertain this type of request is the matter is specifically articulated and presented to the carrier. Again, carriers are in the business of making money and if something is cost effective, most will listen. Similarly, very often community managers push for the use of certain counsel. This can be a positive, because the community managers know who is capable of resolving issues expeditiously. On the other hand, it is imperative that community managers keep the association's best interests in mind.

Many claims may be minor and do not require the assistance of counsel, but an association must not be penny wise and pound foolish in this regard. The basic fiduciary obligation of a board is to seek assistance by professionals when something exceeds the board's competence.

Failure to Protect Privilege

Associations often fail to handle issues in a method that may protect the attorney/client privilege in the event that a matter does, in fact, mature into litigation. This is another reason that a board may want to err on the side of use of counsel and where a board may want to establish one individual or an executive committee to discuss potential litigation issues. This in turn will assist in preserving privilege.

Failure to Properly use Contractors and Deal with Repairs

A common mistake identified by many experts involves property damage claims. As we know, most insurance policies require the mitigation of damages and to address emergency situations. However, what many insured fail to do is limit the fix to those issues and continue to work, sometimes at the encouragement of contactors, before they are approved by the carrier. As indicated, the adjuster must dot his/her "i(s)" and cross his/her "t(s)" before approving a claim.

A common mistake is also signing contracts before reviewing them, not getting the proper bids, and not confirming licenses and insurance. A great tip is to never accept a "certificate of insurance" directly from a vendor. Make sure that the vendor's insurance agent or broker provides you with a current certificate directly and make sure dates of coverage and diary your calendar to confirm that the coverage has been renewed. As hard as it is to imagine, not all vendors have impeccable scruples.

It has also been pointed out that many times the association and/or the community manager may have its own staff to clean up certain damage or loss that should be in fact be handled by professionals. Again, most associations experienced with water damage claims understand that issues involving mold may arise, especially if remediation is not done correctly.

Failure to Understand Coverage

Although substantive coverage issues are not the focus of this article, there are a few basic concepts that arise when indentifying common mistakes in the claim handling arena. These issues are often misunderstood and lead to frustration.

Defense and Indemnity

Insurance comes in two basic forms. First party coverage is where the insured is provided "indemnity" for a loss to his/her/its property. The basic example is property coverage. These claims are handled generally directly between the insured and his or her agent, property manager, or independent adjuster and the carrier. The other is a third-party policy (otherwise known as a liability policy) where the carrier provides two forms of coverage to the insured: (1) a "defense" against a claim or lawsuit; and/or (2) an "indemnity" on behalf of the insured for any liability the insured may have to a third party.

Retention/Deductible

With a few exceptions, most policies and coverages contain retentions/deductibles. This is the amount that the association takes on with respect to the loss. The value of large deductibles could be the topic of another article and should probably be considered by most associations. The issues that are often most misunderstood are the following:

How does the deductible work – does the association have to pay it up front, or is it paid at the end? In the normal course, the initial bills will be handled directly by the association until the retention is exhausted.

A big issue is whether defense fees and costs incurred by the association prior to tender or defense will go to credit the deductible. This is generally not the case. The deductible clock does not generally start to tick until the matter is tendered. This is where many associations get themselves in trouble with carriers by allowing their counsel to handle matters in the beginning.

KEY ADVICE FOR ASSOCIATIONS OR THEIR REPRESENTATIVES FOR SMOOTH AND EFFECTIVE SUBMISSION AND HANDLING OF A CLAIM

This is a topic that if any of us or any of the association's boards or management personnel sat down and really thought this through, they would probably come to the same pieces of advice as are provided below by Attorney Marc Markel. Attorney Markel, one of the leading community association attorneys in the nation provides the five following recommendations:

Call your attorney and request his or her input as soon as possible (an ounce of prevention is worth a pound of cure).

Consult with your association's insurance agent to ensure all coverage requirements are satisfied in a timely manner. (As another professional has also pointed out, make sure your insurance agent is not just a salesperson, but also is an advocate for the association at the time of loss. This is where insurance professionals' experience in this industry is very crucial).

Document everything; take loads of pictures and video if possible.

Do not execute a contract without talking it over with your attorney first.

Beware of assignment of insurance proceeds clauses / one-page contacts provided by contractors.

Engage the services of a licensed engineer that is qualified to oversee the association's efforts.

In addition to the basic recommendations above, other valuable recommendations have been identified:

•**Communication.** It is imperative that all the critical decision makers are kept in the information loop such as the community manager, board members, homeowners, adjuster, carrier, agent, contractor(s), etc.

•**Claim Liaison.** Even though communication is critical, it is just as critical for there to be a designated liaison to be at the center of the communication wheel. It is imperative that an association not have multiple people communicating with the insurance representative.

•**Inclusion.** To obviate miscommunication, it is recommended that when there are key inspections or site visits that all relevant parties participate. There should also be in place an understanding of the scope of the inspection.

•**In Writing.** Although it would seem obvious, it should go without saying that all claim submissions should be in writing and that all communications should be confirmed in writing.

•**Time is Critical.** Each claim should always be approached as if "time" is critical. Rarely is "time" our friend in a claim situation.

•**Protect Privilege.** If a matter has matured into litigation, the insured and all the insured's agents and representatives must be counseled in following the direction of counsel to avoid any impact on privileged matters.

RECOMMENDATIONS FOR CLAIM PREVENTION

Reserve Study

In this author's opinion, the keystone to "claim prevention" and effective community management begins with a reserve study. This opinion presumes that the reserve study is done by a qualified reserve study firm. In addition, it is imperative that the reserves study is properly funded and continually updated. Many claims whether they be property, liability, or director and officer claims can relate back to issues that would have been identified in a reserve study. In a perfect world, the initial reserve study should be completed by the association developer; or at a minimum, there should be a "transition" study done at the time control of the board is transitioned from the developer to the association. In consulting developers, we highly recommend that the commission a reserve study so that there are no surprises or issues that come up and down the road.

Related to the reserve study is the basic notion that maintaining the association in proper repair is critical to claim prevention. Very often when we underwrite director and officer policies, brokers, managers, and association boards wonder why we often ask for financials and/or budgets. Sometimes it has to do with the financial condition of the association, but more often it has to do with whether the reserves are being funded or exist or whether repairs and capital improvements are being completed. If you review an audited financial for an association, you will find many of these issues addressed.

Governing Documents Reviews and Updates

As a connoisseur of director and officer claims, it has become clear that many claims arise from governing documents (primarily the by-laws and conditions, covenants and restrictions) that have not been reviewed or updated. In most situations, governing documents are originally prepared by a developer. In many cases, these documents are "boiler plate." Very often at the time of original development or transition of control, the true needs and nature of an association are not yet mature. Contrary to what many associations may assume, the documents are not written in stone. It is important that the governing documents be reviewed to make sure they work for an association and it is important that they are updated with current law. Very

often a claim arises where an association did "everything by the book," but if the book is wrong, that is not a defense.

A common issue for many associations is the failure to timely memorialize changes and decisions. Although it will shock many of you, there are times when associations to not memorialize decisions or changes at all. As most of you know when a written rule is challenged and the defense is we changed it, but did not memorialize it, we know who will win in the end. *It is imperative that associations keep good minutes and follow the basic rules regarding minutes and the approval of minutes.*

Most claim prevention falls under the old adage of "penny wise and pound foolish." I am not aware of a single jurisdiction in this country that does not have a community association legal specialist that does not have a program whereby the review of governing documents cannot be done and reviewed on an annual basis at a reasonable cost.

Board Education and Training

Most readers are probably on the floor right now from laughter at this sub-topic. It seems too many of us that work for or with community association boards that the volunteer boards "already know everything." It is the fiduciary obligation of the boards to review, investigate and challenge us professionals. That is good. However, there are many boards that either do not seek out counsel or ignore it for reasons that may not be in the best interest of the association. First, it should also go without saying that board members and community managers should know and understand the association's governing documents. Many people sit on volunteer boards and believe that if they use "common sense" that they will be able to do the right thing. As many of us in the real world know, governing documents and laws do not always comport to what the reasonable person would assume is "common sense."

A reality of community association volunteer boards is that in most cases, they are constantly changing. Accordingly, the education and training process does not ever stop. Many of the claims we see involve issues that just would not have occurred if boards read and understood their governing documents, the basic protocol of board operations and having procedures in place.

Another highly effective risk management tool is to make sure that new association members know what their rights, duties and obligations are in the community association. There have been some associations that have commissioned an introductory video for new association members (since we live in a TV generation) that will highlight and focus on important items and those that are often misunderstood. As we all know, the governing documents can often be daunting when delivered or handed over. This can also be achieved by having the association website have a section on "Frequently Asked Questions."

Robert's Rules of Order

One of the common mistakes that boards make is that they do not approach the management of the association as a "business." In most cases, the association incorporates the association's member's greatest financial asset and its greatest lifestyle asset. Yet, boards do not treat the management of the association as it would a business. Many board members sit on the PTA boards, AYSO boards, Church and Synagogue boards, and many other boards. Most properly run boards use some type of Rules of Order. Associations we work with range from 2 to 3 units to 20,000 units. Regardless of the size, the use of a protocol for the operation of meetings will obviate many claims and issues. In the end, most people want their "day in court." The

board must both give all members their opportunity to talk, but they must also limit them pursuant to reasonable and established rules. Boards that have such rules in place generally run more smoothly and meetings are much more efficient.

Professionals

One of the key fiduciary obligations of the board is the management of an association is to recognize where professional assistance is appropriate. I have never seen a set of governing documents (although some may exist somewhere) that does not provide a board with the authority to retain the use of professionals or experts where the matter at hand is beyond the competence of the board. In this regard, when an association or board member is presented with a claim or loss situation, they must evaluate whether they should seek the assistance of a professional.

Early Intervention and Alternative Dispute Resolution

In the community associations, many of the issues that are presented arise out of facts and circumstances that actually are known prior to the actual claim or lawsuit. Many of these disputes could be resolved long before the issues mature into claims or irreversible problems. Associations should also consider having resolution programs incorporated into their governing documents. As indicated, many people just want to have their voice heard and to be able to understand what their rights, duties and obligations are.

WHAT PLANS SHOULD AN ASSOCIATION HAVE IN PLACE PRE-CLAIM TO MAKE THE INEVITABLE CLAIM SITUATION SMOOTHER AND MORE EXPEDITOUS?

In addition to the claim prevention items set fourth above, there are many other items that an association can have in place to both help minimize claims to make the claim situation much easier.

•**Disaster Plan** – Like any entity in the 21st Century, associations should have a disaster plan in place. Each association exists in a unique geographic location that has its own disaster challenges from earthquakes in California, to hurricanes in Florida, to hail in Minnesota. Each potential disaster has its unique challenges and when you live in a "common interest development" you, by definition, have a responsibility for your neighbors to one degree or another. What a disaster plan has to do with claims is it will have in place methods to avoid certain consequential damages or claims and should have teams in place to be prepared and trained to address the issues.

•**Insurance Schedules** – The association should also be aware of its insurance coverage and its deductibles. The association should know (before a claim) what is required and not try and educate itself after the claim has occurred. This is where a schedule of insurance provided by the association's insurance professional comes into place. Also, the association should know whether it needs to contact the insurance agent or the carrier directly in the event of a claim. The manager and the appropriate board members should have a notebook with current copies of all insurance policies including any endorsements.

•**Written Procedures** – The associations should have written procedures in place in the event of a claim or loss.

•**Emergency Authority Matrix** – As one professional has recommended, it is critical that a board know what and what it cannot do in the event of a disaster. What emergency steps and authority does the board or manager have in the event of a loss? Again, reliance on pure common sense should not be the course of action.

•**Alternates Lined Up** – A board should also have alternates in place in the event that a designated board member or manager is not available, or as Murphy's Law would have it, a board that did everything correctly would receive a claim with the person charged

with the handling, is on a cruise of the Greek Islands.

•**Counsel** – If an association has counsel, the counsel should be aware of the association policies, primarily the liability policies where the association may be on the defendant/respondent end of the claim or lawsuit. Also, what terms and conditions of the policy provide with respect to selection of counsel or use of an associations' counsel of choice.

•**Deductibles** – The association should understand what deductibles they have prior to claims and they should have clear policies with respect to how deductibles are handled and who is responsible for what.

•**Association Member Education** – Expanding on the notion that surprises are not our friends, it is highly recommended that the association educate their members on where the Master Association Insurance begins and ends and where the Unit Owners Personal insurance begins and ends. This is often a mystery to associations and their members. This is where the insurance professional can be of great assistance.

•**Vendors** – Like other plan details, it is important to have various vendors lined up, specifically emergency personnel. As we all know, vendors are more than happy to give presentations and to be on call in the event of various issues from water to fire.

Conclusion

The intent of this article is to provide some guidance for the handling of a claim. I do not doubt that many of the readers could provide a more thorough and valuable tool to accomplish this goal. I hope that all those with such information to provide will make it available to our community of community association attorneys.