The Complaint is Frivolous, why should it impact our Insurance?

by Joel W. Meskin, Esq., CIRMS w Featured in Quorum, May 2006

It is a groundless complaint; it will go away soon according to our property manager or attorney – why should it impact our insurance?

As an underwriter of Director and Officer Liability Insurance for some 35,000 non-profit community associations, this is a question I hear on a daily basis. The non profit board of directors and officers in our experience do a fabulous job at the task at hand, however, no matter how well run and governed an association is, there will always be complaints. As a practical matter, if the insurance carrier is involved, expenses will be incurred. Once expenses are incurred, there is an impact on the insurer's costs for providing the insurance, regardless if the complaint is frivolous, false, or fraudulent. A natural consequence is that the cost of the insurance itself in general, will rise and in specific for the individual association.

The challenge is: how can the community association or condominium minimize the claims and resolve them as expeditiously as possible without the necessary involvement of the Directors' & Officers' Liability Insurance, (D&O) thereby keeping insurance costs down? By not involving the D&O Insurance, the association keeps its insurance down. By keeping the insurance down and by keeping it free of minor claims, the premium will be more stable and predictable allowing the board to properly budget and to avoid surprises.

D&O Insurance, like general liability insurance should be viewed as insurance for substantial matters and claims and not as a means for handling the day to day affairs of the Association. Unfortunately, many community associations have looked to their Non Profit D&O insurance far too often and too prematurely. The mandate of the board of directors is to work with the associations at large to ensure that the association complies with the goals of the association. One reason associations are too quick to turn to their insurance for these issues, we believe, is the custom and practice of insurance professionals and agents to recommend these associations to carry unnecessarily low deductibles. In the end, we believe that this is in fact a disservice for the association. In fact, when we take an anonymous poll of our over 4,000 subagents, the vast majority agree with our analysis, but indicate that their inureds are just too used to the low deductibles.

As a side note we must admit that from a premium generation standpoint, we do not necessarily mind the lower deductibles, because we can justify higher premiums. The premises of this article, however, is what can be done to minimize the cost of insurance for the associations and what can be done to create stability and predictability for the associations in budgeting for insurance.

To better understand this issue, let's take a look at an issue I believe each one of us can relate to as individuals. How many of us carry $500 or $1,000 deductibles for the collision portion of our auto insurance? Why do we do this? We do this because although it is not easy, we can personally handle and absorb these losses without having to involve our insurance, thereby keeping our premiums down. In personal auto context, we as consumers clearly understand the cause and effect of this issue. Why then would a community association carry a $1,000 deductible for its D&O insurance where there are many association members to help absorb the higher deductible?

Doesn't the same type of analysis apply to our community association? It is hard to imagine that a community association can not absorb a larger deductible to accomplish the same thing we do on a personal level. In fact, the logic should apply more readily in the larger context. For example, if you have a 100 unit Condominium and there is a $1,000 deductible,

this would be $10 per unit. We spend this much for a couple of coffees or a fast food lunch. If the association carried a $10,000 deductible, each unit, in worst case scenario would be assessed with a $100 charge in the event of a substantial claim, and that would only occur if the association failed to maintain a reserve for such contingencies.

To further understand this concept, we should identify what appear to be the most common claims that are made against the Directors and Officers of a typical non profit community association board. Based on our 20 plus years of experience in this niche, the following are the most common types of claims:
The Board's failure to adhere to by-laws
The Board's failure to properly notice elections
The Board's failure to properly count votes/proxies
Challenges by members regarding power granted the Board by by-laws
Improper removal of Board Members
Decisions by the Board resulting in physical damage to the association property
Challenges to assessments
Approval of variances, generally by an architecture committee
Breach of fiduciary duty
Challenges to decisions of the Architectural Review Board
Questions or challenges regarding easements
The Board's failure to maintain common areas
The Board's failure to properly disburse funds (i.e. insurance proceeds)
Defamation by the Board of a member

When we stand back and look at these types of claims in an objective manner, it is truly hard to believe that the types of disputes giving rise to these claims can not be resolved short of insurer involvement or the need for litigation. The fact is that many of these can be resolved. The reality is, however, that the associations are not motivated to resolve these issues on their own, due in large part to the low deductibles. Specifically, the association realizes why they have insurance.

That is the inherent flaw. This should not be the reason for the D&O insurance. The D&O insurance should apply where the association truly can not itself resolve the matter. Moreover, very often, the property manager or managing agent is too quick to submit this to the insurer to stay out of the mix. This is a key job of the property manager, to manage and to be the professional staff for the board.

The nature of the D&O policy is that the insurers spend money in defense and claims expenses, not indemnity. The Directors and Officers in most cases act in the utmost good faith and within their fiduciary capacity. However, there will always be someone who does not agree with the decisions being made, there will always be someone who believes they are being treated differently than others, and there is always someone who believes that their board is acting in its own best interest. Rarely is that the case. We believe that if those who make these frivolous complaints understand that they will be absorbing some of the expense for their complaints may be less motivated to be quick to pull the trigger and will be more likely willing to try and resolve the issue.

In addition to the increase of deductible, which we believe will help develop problem solving mechanisms for the association, we believe that the instigation of an alternate dispute resolution provision is another method of minimizing the unnecessary use of insurance and the minimizing of costs.

What I propose is that the association asks itself: Why do we have a minimal deductible? The association should also ask the property manager and insurance professional why they have the low deductible. Af-

ter asking these questions, the association should determine whether it would be in its best interest to increase the deductible both for problem solving and cost saving measures. We believe that the need for the low deductible is a bad habit whose time has come and gone.

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