

Making Sure the Good Deed Goes Unpunished: Navigating Director and Officer Liability Insurance for Community Associations

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A community or property owner association ('Association') acts through board members and officers who are volunteers and are generally willing to serve because they care about their communities.

But in this day and age, they are often targets of member lawsuits.

Accordingly, it's recommended that all Associations obtain director and officer liability insurance to cover the costs of defending their directors, officers, committee members, and volunteers against such lawsuits.

The North Carolina Nonprofit Corporation Act, which can be found at Chapter 55A of the North Carolina General Statutes, specifically authorizes Associations to purchase insurance on behalf of an individual who is or was a director, officer, committee member, employee, or agent of the Association to protect against liability asserted against, or incurred by, the director or officer in the director's or officer's capacity or arising from their status as a representative of the Association. An Association may purchase this insurance coverage regardless of whether the Association's governing documents grant it the power to indemnify directors or officers and regardless of whether the Association otherwise has sufficient funds to indemnify against a particular liability.

However, it's important to be mindful that not all insurance policies are created equal and not all policies cover every type of volunteer or every situation. Association directors should carefully consider all options available when obtaining this type of insurance.

Who and What Should Director and Officer Liability Insurance Cover?

Typically, the broader the coverage, the better protection the policy will afford the Association's directors and officers. The following are questions important for the Association to ask when shopping for director and officer liability insurance. Ideally the answer should be "yes" to all of these questions:

- Does the policy's definition of "insured" extend beyond the actual directors and officers (i.e. does it include committee members, volunteers, and employees)?
- Does the policy provide coverage for the Association's property manager if the Association is professionally managed?
- Does the Association have developer-appointed board members? If so, does the policy provide coverage for them?
- Does the definition of "insured" protect past, present, and future directors?
- Does the policy cover spouses of directors and officers?

- Does the policy provide a defense to claims and lawsuits (as opposed to just reimbursing for a judgment if one is eventually entered)? Even a successful defense can result in large attorney and court costs.
- Does the policy cover against defamation (i.e. libel and slander) claims?
- Does the policy provide a defense against claims seeking non-monetary remedies?

A non-monetary, or non-pecuniary, claim is one in which the plaintiff is not seeking money, but instead asks the court for a declaration that the director or officer has acted wrongly (i.e. a suit against the directors for not fulfilling their mission or challenging an unpopular decision of the directors or an officer). Lawsuits filed against Association volunteers are on the rise nationally, and most of these lawsuits do not involve monetary damages, but rather challenge decisions made by the board of directors, such as architectural design and rules enforcement.

- Does the policy cover claims for wrongful termination or other employer liability?
- Does the policy cover claims of illegal forms of discrimination?
- Does the policy defend against a claim or lawsuit for failure to maintain or obtain insurance?
- Does the policy provide coverage for decisions directors/officers make in accepting or rejecting contracts?
- Does the insurer provide the nonprofit corporation with risk management advice?

An Endorsed Insurance Policy or a Standalone Insurance Policy?

For most Associations, particularly those with amenities (i.e. pool, clubhouse, marina, etc.), insurance premiums are the greatest annual cost. Under the North Carolina Planned Community Act and the North Carolina Condominium Act, all Associations in North Carolina are required to carry general liability and property casualty insurance, and these insurance premiums are not inexpensive. In addition, most Associations also carry worker's compensation, fidelity and crime, and director and officer liability insurance, all of which adds to this expense.

As a result, many Associations are looking for ways to lessen their insurance expense burden, and do so by adding additional coverages as endorsements to their liability and/or casualty policies. Endorsements add, remove, or alter the original scope of coverage. The downside of an endorsed policy is that too many claims against an endorsed policy will cause the premiums of the liability/property casualty coverage to increase, and sometimes dramatically. Remember, these premiums are already likely the Association's largest annual expense, so such increases are very unwelcome.

However, most Associations should consider purchasing separate director and officer liability policies, known as standalone policies. Typically only a standalone policy provides the types of coverage that allow an Association to answer "yes" to all 13 of the questions above. While it is true that standalone policies are likely more expensive than an endorsed policy, in our experience standalone policies not only provide better coverage, but they also end up saving the Association money in the long run. Also, if the Association has a standalone director and officer insurance policy, premium increases arising from filing claims will only affect the standalone policy's premium, rather than the total insurance package.

What Should an Insured Association Do When It's Sued?

An Association should notify its insurance carrier immediately whenever a lawsuit is filed against the Association, its directors, or officers. Most policies have a requirement of immediate notice to the insurer, and the failure to give prompt notice may result in complete denial of coverage.

Assuming there is coverage under the insurer's policy, the insurance company will pick up the cost of defending the lawsuit for the Association and any volunteer board members that are named defendants, but it is critical to allow the insurer to be involved in the defense from the beginning.

Summary

Associations have the ability to, and should, obtain standalone director and officer liability insurance coverage. Before

accepting a position as a director or committee member of an Association, you should obtain a copy of the Association's director and officer liability insurance policy to determine whether or not there is sufficient coverage. Serving on an Association board can often be a thankless job, but fortunately, with proper director and officer insurance coverage in place, community volunteers can carry out their duties in the best interests of the Association without fear of paying the cost of legal expenses and judgments out of their own pockets. Volunteer service to an Association should be a good deed that goes unpunished.

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