

# Directors and Officers Insurance

## Must-Have, Or Luxury?

BY A J SIDRANSKY



At the heart of volunteerism is the notion of doing something for the common good. For many, choosing to live in a co-op or condo community is also choosing volunteerism – specifically, volunteering for board service. But within that sense of serving the common good lurks the possibility of liability, and that's what directors and officers (D&O) insurance is all about.

### What's D&O, and How Much Do You Need?

In a nutshell, directors and officers insurance is a form of liability coverage that protects the board members of a corporation or association as indemnification for losses or advancement of defense costs in the event that a good-faith decision made by the board or board members results in damages of some sort.

When it comes to D&O, Alex Seaman, Senior Vice President of insurance company HUB International, recommends that typically, co-op and condominium associations in the New York area "should carry a \$1 million limit. Co-ops and condos often also purchase an umbrella liability policy, which increases limits on both general liability and D&O liability.

This increase can be anywhere from \$5 million to \$200 million, depending on what's needed." Seaman explains further that "umbrella policies are generally purchased through risk purchasing groups (RPGs), which combine top-rated insurance carriers, each taking a portion of the risk. This allows associations to purchase high limits of umbrella liability at exceptionally low premiums. For example, a typical 100-unit property should be able to purchase \$100 million of umbrella liability for a premium of approximately \$4,000 per year. Based on these numbers, there's really no reason not to purchase limits of at least \$100 million of coverage."

### Necessity, or Luxury?

Marc Schneider is Managing Partner at Schneider Buchel, a law firm with offices in New York City and Long Island. He represents numerous co-op corporations and condominium associations. Of D&O, he says: "It's in place to cover the board and board members from any lawsuits against the directors and officers, exactly as it says. However, it doesn't cover everything, meaning that a board might be sued for discrimination – for violating the Fair Housing Act, for example, or denying

a comfort pet – and claims are brought against it. Some D&O policies will give the board a defense with what is called 'a reservation of rights,' meaning that they will defend the suit because they have a duty to defend under the policy, but they are reserving their rights – because if it's determined that the board violated the law, they will not pay any liability that results from the action. The reasoning is simple to explain: you can't buy insurance that covers you for breaking the law."

Schneider goes on to explain that some policies will require the carrier to defend the insured up until it has been determined that the law was violated. Other types of D&O policies won't even give a defense under those circumstances. "D&O is not a free pass to do whatever you please," he says. "Rather, it's there for when the board or the board members are sued for the decisions they make."

Stephen Boonshoft is a partner with Robinson Brog Leinwand Greene Genovese & Gluck, P.C., a law firm also based in New York City. "Every board should have it," he says of D&O insurance. "It is incumbent upon the board to have it. If I represent someone who is contemplat-

ing becoming a board member and their board doesn't have it, I tell him or her not to run." He explains that D&O coverage goes hand in hand with other coverages a condo or co-op should carry, such as general liability, property, and casualty. "If directors are sued as individuals, other coverages will not protect them in this capacity."

### Board Members and Individual Liability

A board member (or the board as a body) may incur personal liabilities as a result of the decisions they make while serving, and under the concept of the business judgment rule. The business judgment rule is a legal doctrine that exists in some form in most common law countries, including the United States, Canada, Great Britain, and Australia. It's derived from corporate case law, and essentially holds that courts will defer to the judgment of corporate executives – including co-op, condo, and HOA board members – where business decisions are concerned. According to the rule, the law accords the directors of a corporation the presumption of being motivated and informed by a genuine regard for the interests of the constituents who voted them into their positions. It does not matter that the position is a voluntary and unpaid.

As long as a board or board member can demonstrate (and a court believes) that a decision was made in good faith on behalf of the community's greater good – even if the result of the decision was a loss or some type of damage – then the court generally defers to the business judgment rule. The board is not likely to be held liable for those losses, and the board's D&O policy will indemnify board members.

On the other hand, if a board or board member is found to have acted in bad faith, in a self-serving, discriminatory or otherwise fraudulent manner, then as stated above, D&O coverage is voided – and they're on their own when it comes time to foot the bill for legal costs or judgments.

### Cost Versus Number of Units

One valid question is whether the added premium costs for D&O are worth the coverage. Clearly, in a large corporation or association where there might be hundreds of owners, the personal relation-

ships and communications that characterize a small association with just a few units don't exist. The intimacy of a small association might go a long way toward avoiding the kind of angry or litigious situation that might result in a lawsuit between the board and one of the owners, particularly as the owner might be a board member. Good intentions may count for more in that kind of situation... or not. Boonshoft recommends that small associations carry D&O insurance in any case. "They still need it, as much as they need all types of liability and casualty insurance. I always counsel in favor of it, but a board can make their own decision."

#### Real-Life Risks

One attorney describes two instances where the lack of D&O insurance might

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have resulted in a financial disaster for the corporation or association. One involved a large co-op in New York City with a no-pet policy that was sued over a resident's right to keep a pet for emotional comfort and support. New York City's anti-discrimination law provides protection for residents in no-pet buildings who have medical proof that they require a comfort animal to alleviate emotional distress. In this case, a complaint was filed in federal court against both the corporation and the individual board members. Eventually the case settled, with the resident able to keep their pet. The insurer paid the legal fees, which were formidable — but since the insurer was not required to pay for any fines under the policy, the damages awarded by the court were paid by the corporation.

Another example offered by the same attorney was triggered by an owner in a

small co-op who lived on the ground floor and had outdoor space in the form of a backyard. He wanted to install a Jacuzzi in his garden, and the board vetoed it. He took them to court and won. The costs of defending the suit were substantial, especially for a small corporation. The D&O policy paid the legal costs in the end, which could have had severe repercussions for the financial health of the small

community—including the shareholder who brought the suit to begin with!

While the cost of directors and officers insurance may seem excessive and/or frivolous to board members when analyzing budgets and trying to hold the line on expenses, it is an 'umbrella' better not left in the closet just because the threat of rain is low. "I came across one corporation where they didn't carry the protec-

tion," says Schneider. "When I explained to them why they needed it, they bought it immediately." It may look like a beautiful, sunny day, but one never knows when the storm clouds may suddenly appear. Keep your umbrella handy. ■

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