

# INSURANCE ADVISORY

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ATTORNEYS SERVING COMMUNITY ASSOCIATIONS<sup>SM</sup>

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## How to Pay D&O Premiums and Still Lose Coverage – Part 2 of 2

By Jay W. Hansen, Esq.

*Part 1 explained how both a former and current directors and officers (D&O) insurance carrier may deny coverage when a potential claim doesn't materialize until after the association changes carriers. Because of this risk, associations and managers must be extremely careful any time a prospective or existing D&O carrier sends an application asking if the board knows of any actual or potential claims. This is a time for extreme caution, not haste.*

### **Never complete or sign an application quickly.**

Before completing it, the board and manager should review the events of the past year or longer for any incidents or complaints that may become a lawsuit or other claim against the association. New directors should review the correspondence of the past year and ask any employees, the manager and legal counsel if they are aware of any incidents that might give rise to a future lawsuit or other claims. If such incidents exist, the prudent course of action is to notify the current carrier of the potential claims before the policy ends, or at the very latest, before the end of any grace period provided in the policy. Also give notice of any claim or potential claim to the proper party, at the address and in the manner called for in the policy, keep a copy, ask for an acknowledgment and follow up.

The safest course of action for providing notice in the manner required by the policy is to provide the actual policy to the association's attorney with any information on the potential claims or claims, then ask the attorney to give notice to the carrier. While many insurance policies require that notice be sent to the carrier by certified mail, return receipt requested, this is advisable even if the policy does not require it, as the returned receipt may be the only proof the association may have that it mailed timely notice. If the association finds that it is really up against a deadline, use a fax that provides a confirmation sheet or even email, if you can find an email address for sending the notice. At least try to speak with someone at the claims department of the company, and use the person's name in any notice of a claim you send to the company. While some carriers allow claims to be submitted through the agents, many times the policy provides that the carrier has not received notice until it is actually received by some employee of the insurance company. If you are anywhere close to a deadline, do not assume that notice to your insurance agent is the same as notice to the carrier.

It is essential that all boards treat the applications for new insurance and changes in D&O carriers with seriousness and great care. The failure to do so can result in paying for uninterrupted coverage and yet being denied coverage when it is needed.

### **How to end up with less coverage than might be expected:**

A second issue that is often overlooked both in D&O and general liability policies is what is sometimes called a "burning balance." Each association should know if defense costs are part of or paid in addition to the coverage limits. The former is what is called a "burning balance," because the carrier will deduct any attorneys' fees and costs incurred to defend a claim from the limits of liability. In other words, under a burning balance policy, the amount available to pay the claims or to settle the case is reduced by every dollar spent in defense. For example, if an association has a \$1,000,000 policy, and a large potential claim (or perhaps multiple claims that could be significant in one policy period), and if the association expended \$150,000 in defending the claim or claims, it would have only \$850,000 left to pay any and all judgments or settlements during that policy period.

If an association is evaluating insurance policies, it needs to be aware that two policies that are identically priced and identical in every respect except for the burning balance are not a comparable value, since the burning balance policy presumably will have less available to pay claims. So, if an association purchases a burning balance policy, it should seriously consider increasing its limits of liability to be sure that there will be enough coverage to pay out any claims that it may encounter.

Also recognize that the limits of liability are the maximum that the carrier will pay in any policy period. So if an association has a \$1,000,000 policy and incurs a \$300,000 claim early in the policy period, there will be only \$700,000 left to pay all other claims that may occur for the remainder of that policy period. Fortunately, major liability claims are rare. However, if an association were to experience a large claim, or multiple injuries or claims arising out of the same incident in any given year, a burning balance could have a serious impact on the association's ability to defend and pay liability claims.

Associations should evaluate their current policies for "burning balance" provisions and anytime they are comparing policies prior to a possible change in coverage.

### **Additional Insurance Information Available:**

For greater details about the issues to consider when evaluating insurance policies, please contact our office at 619-239-1704 or 800-300-1704 to obtain a copy of the "Homeowner Association Insurance Checklist."