A ROADMAP TO INSURANCE CLAIMS

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Of the issues facing community associations, those surrounding how to handle catastrophic losses are among the most complicated. The effort here will be to lay out the issues and concerns in plain language, so that community associations can follow, in essence, a roadmap for processing claims with confidence.

1. The Board's Duty

In the processing of claims, the Board's duty is the same as in all other matters; to act in a fiduciary capacity with respect to its members, and to follow the dictates of the governing documents. Being a fiduciary means holding the funds of the Association in trust. The Board's authority to expend those funds is limited to the purposes for which those funds were collected. Thus, the notion, often held by unit owners, that the Board is entitled to pay claims when it feels sorry for someone, is not valid. If the Board believes that the governing documents are unfair, unworkable, or are otherwise in need of amendment, the Board has the right to bring such issues to the membership for possible amendment.

2. Separation from Fault

The hard part about processing claims is that whether someone was at fault doesn't matter - sometimes. When fault matters and when it doesn't is a difficult matter in its own right, and requires careful attention. In general, an insurance policy insures for catastrophic loss whether or not a negligent act occurs. Suppose a unit owner falls asleep while smoking in bed. He burns his bed, covers, and then certain walls, and then beams and rafters. Suppose the beams and rafters are common elements, and the bed and covers are unit owner elements. The insurance policy for the unit owner should respond, ordinarily, to insure the bed and covers, and the Association's policy should respond to insure the beams and rafters. This is true regardless of the fact that he unit owner was negligent in smoking in his bed.

Likewise, if a maintenance supervisor kicks over an object which sparks and starts a fire that destroys common elements and portions of a unit, the Association's policy would cover the damage to the common elements and the unit owner's policy would respond to cover interior items of damage. The insurance companies may go after one another later, but that fact does not make a difference to the manner in which insurance coverage is handled in the first instance.

The ability of an insurance company to pursue a responsible party after paying a claim to its insured is called subrogation. Most governing documents prohibit subrogation clauses, so that it most often, insurance companies that paid out for damage caused by another will not be able to recover those funds.

3. When Fault Matters

Within the scope of the insurance covered under the policy, fault doesn't matter, unless the conduct that caused the loss was willful or intentional. An arsonist, for example, who burns his unit down, will not be insured. Insurance is for "accidents". Fault matters more often, when the casualty policy does not cover the loss. An example would be in the case of a gutter or fascia, which, over time, due to lack of proper inspection and maintenance, has fallen away, exposing the building to water infiltration, and is left that way for nine months. In such a case, a claim by the unit owner against the association may be made for negligence, especially if the condition was reported repeatedly, and the Association carries liability insurance to cover such conduct.

Likewise, in a case in which an owner fails to maintain the grout around his bathtub, such that water is caused to leak down into the common elements and then to the home of the unit owner below, the owner should have liability coverage as part of his HO6 (condominium) or HO3 (townhouse/PUD) policy. Fault can also make a difference, as will be discussed later, in cases in which the damage is below the deductible.

4. The Governing Documents

The insurance provisions are most often found in the By-Laws, but there are times when certain insurance provisions appear in the Master Deed or Declaration, so you have to check both documents. The governing documents are responsible for the types of insurance the Board is required to obtain and maintain. Most often, the By-Laws will

require that the Board obtain and continue in force, blanket property insurance in an amount equal to one hundred percent of the current replacement value, with standard extended coverage and inflation guard endorsements, covering all of the common elements of the condominiums, except the land, foundations, slabs, excavation and other items normally excluded from coverage.

In such a case, the Association's coverage generally tracks with the maintenance responsibility in the Master Deed or Declaration. In other words, if the Association has to maintain it, then the Association has insured it.

5. Builder's Grade Policies

In some instances, the Association will be required to insure more than just the common elements as defined in the Master Deed or Declaration. Some governing documents require the Association to insure, in addition the common elements, "all fixtures, equipment and other property within the units, regardless of whether such property is a part of the common elements".

In such cases, the Association will find itself purchasing "builder's grade" insurance. This insurance is a casualty policy which covers everything the original builder put into the units, except for those elements purchased as "extras" or "upgrades".

The failure to determine whether the governing documents require builder's grade insurance could cause the Association to have to pay for items such as cabinets that it should have insured, but did not, in the event of a casualty which goes beyond the common elements. In other cases, the Association may wish to purchase builder's grade insurance even though it is not required to do so. Builder's grade coverage has the advantage of insuring for many aspects of the units, in cases in which a unit owner failed to obtain insurance or allowed insurance coverage to expire. The disadvantages include, that there may be an additional expense for the additional coverage, and the fact that it will often be the case that the Association will be filing the claim and accumulate a more substantial claims history.

6. Unit Owner Policies

In general, the insurance policies issued to unit owners are designed to dovetail with the policies issued to the Associations. In the condominium setting, the unit owner policy designed to dovetail with the Association policy is the HO6 policy. In general, it covers personal property of the unit owner, and anything within the definition of "unit" in the governing documents. In the homeowner's association setting, the HO3 policy is intended to cover everything the unit owner owns, such as roofs, gutters leaders and siding, even though under the governing documents, the Association may be responsible for maintaining those items.

7. When a Loss Occurs

Losses occur in a variety of scenarios. Sometimes the loss only occurs to a unit. Sometimes a loss only occurs to the common elements. More often, however, a loss will occur to several units, and to the common elements. In such cases, because the insurance policies are designed to dovetail, it is relatively rare when there is no insurance for a loss. More often, the conflicts arise as to whose responsibility it is to perform the repairs, and who holds the money. In most cases, the governing documents have provisions which determine these issues.

Most often, when there is damage only to a unit, (and the Association has coverage, such as in the case of builder's grade insurance) the unit owner is permitted to make the repairs himself, and any amount of money obtained in insurance proceeds is applied to that repair. The Association usually has its claims adjuster come out and assess the loss. The Association receives a check, and provides a check to the unit owner, upon obtaining his signature on a release, signifying that he will make no additional claim against the Association.

When the damage occurs to several units, the Association's adjuster determines the damage to each unit, and the cost of repair. The Association receives the check and divides the insurance proceeds among those whose units were affected. This rarely happens without common element damage. When the common elements are damaged in addition to the damage caused to the units, the Association is commonly charged with repairing the damage, not only to the common elements, but also to the units.

The New Jersey Condominium Act, specifically N.J.S.A. 46:8B-24 requires that "Damage or destruction of any improvements on the common property or any part thereof covered by insurance

required to be maintained by the Association shall be repaired and restored by the Association using the proceeds of any such insurance. The unit owners affected shall be assessed on an equitable basis for any deficiency and shall share any excess." In a rare exception to the general rule that the statute governs in cases of inconsistency with the governing documents, the statute in this case defers to the Master Deed and By-Laws.

8. When Insurance Coverage is Insufficient

Because the Association insures at full replacement value, it is relatively rare that insurance proceeds are insufficient to cover the losses. In the event that this occurs, however, the governing documents usually determine the result. Most often, the Association is directed to assess the units affected in accordance with their percentage ownership interests in the common elements. This means that if unit owner A has only nominal damage, but unit owner B has his unit completely destroyed, each unit owner is nevertheless assessed in the same proportion as when he pays his maintenance fees. Boards are not free to adopt a different scale because the assessment seems unfair. Some unit owner policies cover these assessments, but often they do not. Unit owners need to review this aspect of their policies with their insurance agents.

9. When Losses are Below the Deductible

Early in the history of community associations, deductibles were rarely a significant issue, because the deductibles were so low. If two or three unit owners were making up the shortfall in insurance caused by a $1,000 deductible, no one was hurt badly enough that it caused a major problem.

Today, this is not always the case. Since hurricane Katrina devastated New Orleans, deductibles have risen steadily, such that it is no longer uncommon for Associations to carry a $10,000.00 deductible. If a shortfall in insurance is assessed to a single unit owner under those circumstances, it could drive some to bankruptcy.

Some associations have adopted Resolutions in attempts to diminish the perceived unfairness or the harshness of the result. This is not appropriate. One cannot undo a By-Law by passing a resolution. Resolutions are instruments which create policies or procedures in order to carry out the dictates of the governing documents. In cases in which the Association carries a high deductible, there should be interaction with the community, explaining the benefits and detriments of carrying a high deductible and making sure that the owners understand the risks associated with the deductible.

The Board would be wise to counsel its unit owners to consult with their insurance agents about buying insurance policies or riders which would pay the deductible or their share of it, and performing their own cost-benefit analysis. It may be that the governing documents have to be changed in this regard. Open discussion with the unit owners on this point should occur. In cases in which the governing documents are silent as to what occurs when the losses are below the deductible, it becomes important to have a Resolution which sets out the responsibilities of the Association and the unit owners.

Such resolutions often provide, unless the governing documents state otherwise, that:

a) when damage occurs to a common element, the Association will pay the amount necessary to perform the restoration;
b) when damage is to a unit, the unit owner pays to restore his unit; and
c) when the damage is to several units, the unit owners pay the cost of repair in accordance with their percentage interest in the common elements, or in accordance with the proportion of damage done to each unit, as the Resolution determines.

When both common elements and units are damaged, the Resolution often provides that the cost of repair be apportioned according to the dollar amounts of the respective losses.

10. Who pays when there is No Insurance?

This category of claims is often the most contentious. These claims often arise without a clear cause, and the cooperation of sometimes-difficult unit owners is necessary to find a solution.

Let us suppose that a downstairs unit owner woke to discover that he had a hole in his ceiling and a flood of water in his living room. His immediate reaction is to call the management company or the building superintendent if there is one. Somebody shuts off the water, and then, it becomes

important to the downstairs unit owner to find out what is causing this water to enter his unit, and determine who is responsible for the repairs.

The common elements between the two units consist of the trusses and sub flooring to the unit above. The unit owner above the location of the leak refuses entry, because he has no insurance, and doesn't want to deal with the problem. He insists that the cause of the leak is not him. The Manager calls the attorney for advice. The attorney researches the governing documents and there is no guidance whatsoever on the subject. What advice should the attorney provide?

This is what I have done. This is probably not the only way to handle the matter, but it does get the problem solved. I require the downstairs unit owner, as a prerequisite to Association involvement, to have a plumber come out, open up the sheetrock and see if he can determine the likely source of the water infiltration. I am looking for two things from the plumber at that point. I want the plumber to tell me that he can't determine the cause of the leak without inspecting the upstairs unit, and I want him to tell me that the common elements got wet, and if action is not taken mold could result or there could be other damage to the common elements.

The Association will not be paying for the diagnosis. The downstairs unit owner who suffered the damage should also file an insurance claim. Armed with this information, assuming there has been some common element damage, the Association would be within its rights to determine the source of the leak, and may do so by requiring access to the units of other owners.

11. Construction Defects and Other Exclusions

This is another difficult subject with different results based upon different scenarios. In general, the Association is responsible for the maintenance, repair and replacement of the common elements. As a matter of maintenance, it should be repairing construction defects in the common elements. It is not, however, insured for this function. As we pointed out before, insurance is for “accidents”, not defects. Many an insurance claim has been declined because of careless talk about defective conditions.

The fact that shingles blew off the roof in a storm does not necessarily mean that the shingles were installed in a defective fashion. Yet managers and unit owners alike often speculate that the shingles must have been installed in a defective manner, or they would not have blown off. Days later, they receive a denial of the claim in a letter filled with policy provisions they never saw before, which quotes the manager or unit owner as having admitted that a construction defect was the cause of the loss.

Every once in a while, a unit owner insists upon initiating a claim, directly with the Association’s insurance company, to cover losses to his unit. Any such effort should be opposed. The most important reason for this is that the information in possession of the Association is often overlooked when this occurs. The Association sometimes finds out later that representations were made to the Association’s insurance company about the cause of the loss, or the Association’s “negligence” which are unsupportable and sometimes just false. Sometimes, as in the scenario above, the unit owner starts talking about the conditions which caused the loss being caused by construction defects, and then when the claim is denied, the unit owner wants the Association to pay.

CONCLUSION:

Hopefully, you have found this article helpful to a general understanding of insurance coverage, and the handling of losses. I cannot emphasize enough the importance of reading your governing documents and the applicable insurance policies, when handling claims. As many have learned the hard way, operating by rules of thumb is not an adequate approach to processing insurance claims.

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