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WATER DAMAGE CLAIMS IN YOUR CONDO ASSOCIATION

UNDERSTANDING THE PROPER ROLE AND USE OF ASSOCIATION INSURANCE

INTRODUCTION

Many condominium associations face problems due to a misunderstanding of how their association's policies of insurance operate and should be utilized—especially in connection with property damage emanating from broken pipes or plumbing fixtures. Those problems include, among others: (a) denying owners the benefit of the insurance coverage to which they are entitled; (b) having the association assume broader repair responsibilities than what it legally must or should; and (c) failing to adopt policies to allow for losses to be resolved in consistent, equitable and cost-efficient manners. The purpose of this article is to address these problems by dispelling some of the confusion at their core. In doing so, we provide recommendations as to how condominium associations should approach water damage claims with the assistance of their insurance and legal professionals. Those recommendations include what we believe every condominium association should adopt as part of their operating rules: a "Water Loss Policy."

THE ALLOCATION OF MAINTENANCE AND REPAIR RESPONSIBILITIES

The allocation of maintenance and repair responsibilities is perhaps one of the most significant factors affecting a condominium association's operations. Under the California Civil Code, everything that is included within the boundaries of an owner's condominium unit (the owner's "separate interest") is to be maintained, repaired and replaced by the unit's owner. Everything that is not included within those boundaries is generally common area (or "common elements") which the association is required to maintain, repair and replace. *Civ. Code* §§ *4095(a)*; *4775(a)*.

There is the potential for a condominium association's declaration (its "CC&Rs") to impose a different allocation of maintenance and repair responsibilities than what is set forth in the Civil Code. However, in our experience, it is rare for any condominium association to be structured in a way that requires owners to maintain, repair or replace anything that constitutes common area, or to have the association maintain, repair or replace elements within the boundaries of an owner's unit.

It is therefore important to understand the true boundaries of an owner's condominium unit. The overwhelming majority of California condominium units are structured as "airspace" condominium units. The boundaries of an airspace condominium unit typically extend to the interior, unfinished surfaces of the unit's perimeter walls, floors and ceilings. Everything existing within those boundaries (e.g., the paint on the walls, the finishes placed on the floor, appliances, cabinetry, etc.) are therefore part of the unit which the owner owns, and which are to be maintained, repaired and replaced by the owner. Everything existing beyond those boundaries (e.g., the physical drywall, the subfloor, and the utility components existing within those areas) are generally common area components. *Civ. Code* §§ *4185(b)*; *4095(a)*.

There is a third category of component existing within condominium developments: exclusive use common area. Exclusive use common areas generally include "shutters, awnings, window boxes, doorsteps, stoops, porches, balconies, patios, exterior doors, doorframes, and hardware incident thereto, screens and windows or other fixtures designed to serve a single separate interest, but located outside the boundaries of the separate interest." *Civ. Code § 4145(b)*. Unless the CC&Rs state otherwise, such components are to be maintained by the owner but are to be repaired or replaced by the association. *Civ. Code § 4775(a)*. These components are located in areas to which owners generally have access and can be maintained by the owner without having to physically pierce or tear through common area walls, floors or ceilings.

Most condominium associations should therefore expect that a pipe located within a wall, floor or ceiling is a common area component for which the association is responsible. For example, the water supply line connecting a toilet to the wall stub-out is within the boundaries of the unit (within the unit's "airspace") and is therefore the owner's responsibility. However, the pipe in the wall to which that stub-out

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is connected is not within the boundaries of the unit. Rather, it is a common area component to be maintained, repaired and replaced by the association. That is generally true irrespective of whether that pipe in the wall "exclusively serves" that unit. If this is contrary to your association's understanding, then your board should consult with your association's legal counsel to ensure that the association's operational model is consistent with what the law and your association's CC&Rs require.

INSURANCE CLAIMS ARE DEPENDENT ON COVERAGE, NOT "RESPONSIBILITY"

We have seen associations run into problems by conflating the issue of *maintenance responsibility* with the separate issue of *insurance coverage*. Let's continue with our toilet supply line hypothetical to illustrate this. Assume the supply line failed and caused significant water damage to the unit (e.g., to the hardwood flooring, baseboards, and cabinetry), as well as damage to common areas bounding the unit (e.g., the drywall, the studs in the drywall, etc.). Assume further that the owner requests that the association file a claim on the association's insurance policy to cover the costs of repairs.

Upon receipt of the request, the association reviews the matter and identifies that the cause of the loss was a failed supply line—an element for which the owner is responsible. The association may then attempt to view the loss as the owner's "fault" because the supply line is the owner's "responsibility." With that in mind, shouldn't the association then refuse to file a claim on its insurance and instead tell the owner pay for all repairs to his unit and to pay for the association's costs of repairing the common area? As discussed below, the simple answer to that question is "no."

This hypothetical addresses the first problem identified in this article's introduction: denying owners the benefit of the insurance coverage to which they are entitled. The association is required via its CC&Rs to purchase and maintain insurance covering damage to the common areas and in many instances to the owner's units as well (i.e., associations that have "full replacement" or "walls-in" coverage). The insurance premiums the association pays for that coverage are funded by the assessments payments of its owners. The owners are therefore paying for the coverage and are the intended beneficiaries of the association's insurance policy. In other words, the association's insurance policy may be viewed as the *owners'* insurance policy.

> *"…the association's insurance policy may be viewed as the owner's insurance policy."*

When a loss is sustained the question of who was "responsible" for the loss or the failed/leaking component is not immediately relevant. The relevant question from the insurance carrier's perspective is whether there is *coverage* for the loss. If the association's policy provides coverage for the repair costs, the association may not—and should not—deny the owner the benefit of that coverage by refusing to file a claim. In many instances, refusing to file a claim precludes the owner from filing a claim on his individual insurance policy because the association's policy is typically "primary" (meaning it must be utilized first before the owner's insurance carrier will step in). This often results in a contentious dispute with the owner where legal expenses are then incurred in sorting things out.

Avoiding such disputes is just one of the benefits of filing claims. Assume in our hypothetical that instead of the supply line failing, the pipe in the wall failed. The situation now involves a loss emanating from something for which the *association* is "responsible." One would expect the owner to be adamant in demanding that he be paid for the costs of replacing all damaged areas within his unit, including perhaps his opulent Italian marble flooring. If the association files a claim, and coverage

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is provided, the owner is afforded the benefit of that coverage and issued proceeds by the insurance carrier. However, what if the association files a claim and no coverage is provided due to some exclusion being triggered under the policy? Shouldn't the association then take it upon itself to pay the owner for restoring all damage to his unit? Here, again, the simple answer is "no."

This answer touches on the second problem listed in this article's introduction: having the association assume broader repair responsibilities than what it legally must or should. "Responsibility" and "fault" are not the same thing. Yes, the association is responsible for the pipe. However, was the failure of the pipe because of some "fault"—meaning *negligence*—on the part of the association? To answer "yes" to this question one must argue that the association was negligent in maintaining the pipe; that the association failed to uphold some standard of care or duty to ensure that the pipe would not break or burst. This argument does not hold water. The association cannot be reasonably expected to snake every pipe or to perform some other form of ongoing, community-wide pipe maintenance or inspection regimen which would have prevented the loss. Water losses resulting from pipe failures are rarely anyone's "fault." The inability to prevent such occurrences are one of the many reasons for insurance. Insurance mitigates a risk that, by its nature, cannot be effectively mitigated through other means.

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If the association's policy does not provide coverage, then the owner is notified of that fact and directed to file a claim with his carrier. The association need not, and should not, opt to then pay to repair the owner's unit. Again, the issue of "responsibility" or "fault" is irrelevant—the only issue which is relevant is *coverage*. If there is no coverage, then the default allocation of maintenance and repair responsibilities comes into play. It requires the Association to repair what it is responsible for (the common area such as the pipe within the wall, drywall and studs) and the owner to repair what he is responsible for (everything within this unit such as the flooring and cabinetry).

YOUR ASSOCIATION SHOULD NOT OPERATE AS AN INSURANCE CARRIER

We have seen some communities that, for a myriad of reasons, develop the dangerous practice of paying to repair damage to unit interiors emanating from association-maintained pipes. They often do so because of a misplaced fear as to the impacts that filing multiple insurance claims will have on their association's insurance premiums and future insurability. Those associations do not understand that they will never be able to process claims and repairs in more effective or cost-efficient ways than national insurance carriers and their trained claims adjusters. Any association which ignores this fact and instead tries to act in the role of an insurance carrier does so to the financial detriment of itself and, by extension, its owners.

If an association is that concerned about the impact multiple claims will have on its premiums and insurability, the answer is not for the association to "self-insure." Rather, there may be a need to revise its insurance policies and/or its water loss deductibles, or to solve the root cause of the recurring plumbing problems by pursuing a community-wide re-piping project. The imprudent solution is for the association to self-insure by building a large "water damage repair" line item in the association's annual budget. For associations that are self-insuring, the importance of consulting with your insurance and legal professionals cannot be understated.

WHAT EVERY CONDOMINIUM ASSOCIATION SHOULD DO: ADOPT A WATER LOSS POLICY

An association that is dealing with some of the issues identified above should enlist the help of its legal and insurance professionals. Working in cooperation with these professionals will shed light on the proper role and use of insurance, as well as the protocols that should be implemented by the board and management to properly respond to water damage claims. Doing so touches on the third problem listed in this article's introduction: associations that fail to adopt policies to allow for losses to be resolved in consistent, equitable and cost-efficient manners.

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One of the best policies an association can adopt with respect to this issue is what our firm refers to as a "Water Loss Policy" or "Water Intrusion Policy." This policy has numerous benefits. Among them include notifying owners of the following important issues: (a) the scope of the association's insurance coverage, (b) the scope of coverage owners must purchase for their individual units, (c) how deductibles are treated, and (d) the duty owners have to immediately notify the association of any water intrusion issues. The following paragraphs focus on items (c) and (d), respectively.

When a claim is filed on the association's insurance policy, any proceeds provided by the carrier will be reduced by the applicable deductible amount. Most CC&Rs do not contain language addressing who is responsible for that deductible (the association or the owner). In the absence of such language, the Water Loss Policy should be drafted to require the owner who stands to benefit from the claim (i.e., the owner whose unit was damaged) to assume the deductible. Although the owner will not receive 100% of the money he needs to restore his unit, most individual owner insurance policies will step in and provide coverage for repair expenses not covered by the association's policy. Accordingly, through a combination of the association's insurance and the owner's insurance, the owner should receive most--if not all—of the money he needs to repair his unit and to restore it to "pre-loss" condition. Disclosing this information in the Water Loss Policy is vital; it (a) prevents potentially costly disputes, (b) helps owners understand the need to verify the adequacy of their individual insurance policies, and (c) mitigates the financial impact of insurance claims on the association.

The existence of a plumbing issue is often not immediately apparent to the association's board or management. Rather, it will be apparent only to the unit's owner or occupants who observes the leak and the corresponding damage. It is paramount that those people notify the association of the situation immediately. Most insurance policies contain a significant exclusion for water damage claims where the damage was not "sudden and accidental occurring over a period of less than fourteen (14) days." This means that if a pipe is leaking for multiple weeks or longer, the exclusion is triggered and no coverage will be provided by the carrier. The absence of coverage in such cases is especially devastating because of the significant amount of damage that has likely resulted from the ongoing pipe leak that was not reported in a timely manner.

The Water Loss Policy therefore imposes a clear duty on each owner to immediately notify the association of any perceived pipe leaks or water intrusion issues. If the owner breaches that duty, and as a result no coverage is provided, the association is in a better position to recover the repair expenses from the owner through a special reimbursement assessment or other means. It is in this case that the issue of "fault" (or *negligence*) finally comes into play. The association has been injured (i.e., no insurance coverage and/or increased costs of repair) because of a negligent act or omission on the part of the owner. The Water Loss Policy is therefore utilized to seek reimbursement from the owner and/or his liability insurance carrier. Moreover, the ability to point to a negligent act on the part of the owner (as supported by the Water Loss Policy) often assists the owner in obtaining coverage from his carrier.

RECOMMENDATIONS

Understanding the proper role and use of a condominium association's insurance policy is paramount when addressing water damage claims. Without that understanding, an association may act in ways that cause more harm than good—both for the association and its owners. If the information contained in this article is contrary to your association's understanding or historic practice, it is recommended that you consult with your association's legal and insurance professionals for further guidance.

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