

The Condominium Insurance Claim Game

by Joel W. Meskin, Esq., CIRMS ♦ Featured in New England Condominium, August 2005

Insurance is a necessary evil in our lives. We can't live with it, and we shouldn't live without it. And when we move into a condominium, or any other community association, where our investment in our home and our lifestyle are intertwined with other unit owners, our insurance needs become more complex. The key difference between an individual homeowner and a homeowner in a community association is the impact to the individual unit owner of the common-interest elements of the community.

Truth be told, all homeowners are fully insured, regardless of whether or not they buy insurance. How so? If an individual homeowner or an association chooses not to buy insurance, that homeowner or association, by default, becomes their own insurer because they will be paying for the uninsured repairs out of pocket if any damage occurs. They are, in other words, self-insured. But assuming that an association plans to buy coverage, there are many details to keep in mind as you evaluate the insurance program and the exposures that need to be covered by the association, and those that are the responsibility of the individual unit owner.

First, players must understand what coverages make up the basic community association insurance program. With that general understanding in hand, players can test their basic acumen by playing *Who Wants to Be a Fully Insured Community Association?* Playing the game will clarify which insurance policies cover which exposures, which exposures may be covered by some policies and not others, and which exposures are more properly covered under the individual unit owner's policy.

An Association Insurance Primer

Insurance is not a simple issue. A homeowner who owns a home that is not part of a homeowner's association is concerned with purchasing an individual policy to cover his or her dwelling. The policy should include replacement cost coverage, sufficient limits, adequate contents coverage, and liability coverage, in the event that homeowners is found liable for someone being injured on his or her property. Additional bells and whistles are also available.

If, on the other hand, a homeowner owns a home or a condo unit that is part of a homeowner's association, the complexity of insurance needs grows exponentially, because this homeowner

has an investment in common elements or common interests, in addition to the investment he or she maintains in his or her own unit. These common elements give rise to additional assets that need to be protected in the master insurance policy, as well as additional liability exposure that places the homeowner's personal assets at risk.

Many homeowners mistakenly believe that when they move into an association, all their insurance needs for their insurance needs for their individual units are covered by the association's master policy. But with very few exceptions, this is not the case. In addition to the association's master insurance, the cost of which is included in the association maintenance fees, the individual homeowners should maintain his or her own policy to cover any exposures that are unique to the individual unit owner and not shared in common with the other unit members. The homeowner should consult an insurance agent to be sure that the individual's insurance program dovetails as closely as possible with the association's coverage. If an agent asks no questions about the association coverage, it is time to get a new agent.

What insurance should an association carry? To find out, every association must be evaluated individually to be certain that all its unique issues are addressed. This is where a community association insurance specialist is worth his or her weight in gold. The following are areas of coverage that virtually every association will need:

Property Coverage

Each association has common physical property that is owned by the members of the association. This property can be as simple as a fence around a single-family homeowner association with some landscaping, or it can be as complex as a 40-story building with 200 or so individual condo units, an elevator, a basement recreational facility or pool, and a boiler and a large number of machines. Many issues arise from considerations of what limits are necessary, where the association's responsibility ends and the unit owner's begins, determining replacement costs, and determining new ordinance coverage. Any item that is damaged and not covered by the master insurance policy will be, by default, self-insured by the association. Self-insured means that the community will be paying for repairs through special assessments. Decisions about which coverage to purchase become especially complex when associations contemplate very expensive coverage, such as earthquake, windstorm, or other coverage that is not standard in a policy.

Liability Coverages

Associations have common liability exposure. Common areas are owned by the members, and they are managed at the direction of the association's own form of government (normally the board of directors, which in turn directs employees or a property manager). If someone is injured, the association will be responsible. How much

coverage an association should carry is generally decided by the board of directors, with the guidance from property managers and insurance professionals. Liability coverage defends an association in any action that seeks damages from bodily injury or property damage as a result of the association's negligence. One coverage that is usually not standard and must be purchased is personal injury coverage, which protects the association against various claims for the standard listed offenses, which are defamation, invasion of right of privacy, wrongful eviction, malicious prosecution, or false imprisonment.

Directors & Officers Coverage

The articles of incorporation are the document that transform a community of random homeowners into an association. Once an association is formed, it is a legal entity that, like a corporation, cannot run on its own. Accordingly, the association will normally have a set of bylaws, which are the handbook on who will run the association, how those people will be chosen, and how they will govern. These boards are made of well-intentioned homeowners volunteering their time. But boards are comprised of human beings. And human beings make mistakes. And even if they do not make mistakes, they are certain to be challenged for some of the decisions they make. Virtually all associations have provisions to indemnify the directors and officers for their mistakes in the event that they are challenged. But the association must decide whether they want to carry this insurance or whether they prefer to be self-insured. The D&O coverage is probably the most complicated, because the differences in coverage that are available between carriers can be substantial.

Fidelity / Crime Coverage

One of the most neglected areas of insurance for an association is fidelity coverage, which is also known as employee dishonesty coverage. If a policy is properly tailored for community association, the definition of insured will include the directors and officers, employees, property managers, and their employees. Community associations are businesses, and they maintain checking accounts, reserve funds, and capital improvement funds. What happens if someone walks off with the money? If the community association policy is prepared properly, its insurance coverage will include a crime component. The crime coverage comes into play when a non-employee takes money from the association. A professional should determine how much coverage is needed.

Umbrella Liability

This is a complex issue for associations. What exposure does the association have? Normally, the general liability policy provides \$1,000,000 or \$2,000,000 in coverage. Is this enough? What if a child drowns in the community's swimming pool? What if the

superintendent is fixing something on the roof of the complex and drops a piece of equipment, which falls off the roof and lands on 10 pedestrians below, killing three and rendering four quadriplegic? Will the general liability limits be enough? Does the umbrella policy being considered cover excess D&O or employment liability?

Homeowner's Policy

Each and every homeowner should have his or her own policy. But there are specific issues that must be evaluated in conjunction with the coverage carried by the association. Does the homeowner's policy pick up where the association policy leaves off, especially for improvements and betterments? Has the homeowner been told about loss assessment coverage, and how it works, and if he or she has purchased enough under the homeowner policy? The loss assessment coverage picks up when the association assesses the homeowner for something that would have been covered under the association's policy, but for insufficient limits.

Now, test your insurance acumen by playing the game.

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The Game

The Objective

The object of the game is to match a claim, damage, or loss to the policy that will provide coverage, if any. There is a possibility that more than one policy may provide coverage.

Before beginning, players should understand the distinction between a first party insurance claim and a third-party claim. In the first-party claim, the insured sustains loss to his/her/its property (for example, a building fire) and makes a claim for the insurer to pay for the damage. In a third-party claim, a lawsuit or a claim is brought against the insured seeking recovery (if, for example, someone slips and falls on the insured's property and sustains injury). In this case, the insurance policy can provide a defense on behalf of the insured, and it may provide indemnity (payment of a judgment for which the insured becomes legally liable). Sometimes the insurer will pay defense and indemnity and sometimes only defense.

The Instructions

The game can be played alone, with your board of directors, or at your association's annual meeting.

Column 1 contains descriptions of a claim. Claims start with the easiest and work up to the \$1 million question.

Columns 2 through 7 identify an insurance coverage form or policy that may provide coverage for the identifies claim.* These include:

- PC for property coverage
- GL for general liability coverage
- D&O for directors & officers liability coverage
- F&C for fidelity (employee dishonesty) and crime coverage
- U for umbrella liability
- HO for homeowner's policy

To play the game, read the claim and then select where there may be coverage or if there is coverage available. For extra points, determine if the policy will provide indemnity, defense, or both.

In Columns 2 through 7, insert one of the following:

- C for coverage
- NC for no coverage

For extra credit, if there is coverage, add either D for defense only, I for indemnity only, or DI for both defense and indemnity.

Life Lines

Phone Call**

- Call your association's insurance agent
- Call your property manager
- Call your board of directors
- Call your association's attorney
- Poll your neighbors or other association members

Play the Game

Level \$100	Claim Clubhouse burns down.	\$100,000	remediated.
\$200	Teenager is injured in a bike crash on a condo parking garage speed bump that is higher than the local ordinance allows.	\$2,000	A condo unit owner makes a claim against the association stating that the steps leading up to her unit are defective and do not meet code. The claimant demands that the defect be corrected by the association.
\$300	A claim is brought challenging an election of the board of directors and demanding that the election results be nullified and that a new election with a new mailing of election notice be held.	\$4,000	The property manager's employee has disappeared with \$21,347 of the association's maintenance fees.
\$500	Property manager has been taking 50% of the quarters from the condo laundry room for the past five years, amounting to \$25, 000.	\$8,000	The association sues the property manager to recover diminution in value of association due to poor maintenance.
\$1,000	A homeowner demands that the mold that has taken hold in a wall between one condo unit and the recreation club locker room be cleaned up and	\$16,000	A unit owner claims that a board knowingly allowed a registered sex offender to be elected to the board and demands that the board dismiss this recently elected board member.
		\$25,000	A developer who still controls the board of the association is sued for alleged failure to install a pool that was promised in his marketing material.
		\$50,000	A child drowns in a community pool that was equipped with a broker self-locking and -closing gate.
		\$250,000	A unit owners sues the association president because he entered the unit owner's condo without notice to remove two of her four dogs (two of which are pit bulls) because they violated the condo's two-dog rule. The president, in turn, sues the property manager after being bitten by one of the pit bulls during the attempt to remove the dogs. As the president and the property manager tried to exit the unit with the two dogs, the unit owners blocked the door, preventing the president from leaving until the police arrived.
		\$250,000	The association's general liability carrier denied coverage for a sexual harassment claim. The claim was made against an independent property management company employee by the association=employed doorman. The property manager employee had harassed other people in the past and had served time in prison for

sexual molestation of minors. The association spends \$135,000 to defend the action. The doorman receives a judgment against the property management company for the employee's conduct in the amount of \$15,000. The association issued as assessment of \$6,000 against each of the 25 unit owners. The unit owners seek coverage to pay for the loss assessment issued to the unit owners to recover the \$150,000.

\$500,000

The same scenario as above, but in this case, a group of association members sue the board of directors for failure to procure coverage to cover this issue. On behalf of the association, the same members sue the property manager for negligent hiring and failure to advise on the proper insurance.

\$1 Million

An association member runs into the clubhouse's glass door (which has no decals on the glass), smashing the door, which falls inward and breaks the newly installed clubhouse entertainment center. The center cost the association \$35,000. In the process, the member breaks her nose and passes out. After she regains her senses, she is compelled by the board, against her wishes, to remain in the clubhouse for an hour. During the hour, the board meeting continues and one board member comments to the 40 association members in the building that the woman who is injured is fat, clumsy, and always falls down. The woman's husband, who is also a board member, hits the man who makes the comment, breaking his nose. The two with broken noses sue the board and the association, but unfortunately, the insurance company that wrote the general liability policy filed bankruptcy.

*In the condominium insurance puzzle, coverage might also include automobile coverage in the appropriate situation, workers compensation coverage where there are employees and a boiler & machinery coverage.

**If you are not able to get your answer from one of these life lines, or immediately after making the request, it may be time to shop for a new community association professional.

The Answers

Very often, the answer to many of these questions will be "it depends." Why? Because not all insurance policies are created equal. This fact is especially true in the director's & officer's liability arena. In the community association insurance industry, there are two major insurance players. There are also insurers that underwrite stand-alone monoline policies, and insurers, including direct writers, that offer package policies that bundle the different coverages needed by the associations. Package policies generally offer most of the coverages set forth in Columns 2 through 7. The differences between types of coverages are especially important when evaluating specialized coverages, such as directors and officers coverage, where some of the stand-alone policies are much broader than the coverages bundled in the package policies.

The key to having the best and broadest coverage is to make sure you are working with experienced community association specialists, including your property managers, attorneys, and insurance brokers.

\$100

The PC box should have an I for indemnity. The insurer will respond subject to the policy terms and conditions to the fire loss. Extra credit is also available if someone checked the HO box. If the coverage the association purchased is insufficient, and the association had to assess the individual association members, the loss assessment coverage under the HO policy, if it was purchased, would be available since it was a covered loss under the association's policy.

\$200

The GL box should have a DI for defense and indemnity. There may be some defenses to the liability issue, but the association will be defended in the claim and, if found liable, the carrier will pay on behalf of the association. As indicated in the \$100 answer, if the limits were insufficient, the HO loss assessment coverage may step in. The D&O policy would not respond for the improperly constructed speed bump because of the D&O's bodily injury exclusion.

\$300

The D&O box should have a D in the box. However, it may not be in error to have no boxes checked. Stand-alone D&O policies generally defend a claim seeking non-monetary relief such as this (and one carrier on the market would pay for the cost of a new election). In fact, this is one of the most common claims that exist. The majority of claims seek some form of non-monetary relief. A number of the D&O policies contained in the package policies do not provide a defense for claims seeking non-monetary relief.

\$500

The Fidelity & Crime box should have an I. There are a few issues to keep in mind with this claim of loss: First, not all package policies have fidelity (employee dishonesty) coverage. Second, if they

do have coverage, there may be a sub-limit, such as \$2,500, \$5,000, or \$10,000. This may have no relation to the amount of coverage the association needs. If the insurance broker or property manager does not address this issue, you should question the service you are getting. Another issue is whether the property manager is a named insured. Additionally, often the package policy's coverage is limited to employee dishonesty and does not extend to crime. Good stand-alone community association fidelity/crime policies should take care of these issues.

\$1,000

There should be no mark in any box. Virtually every policy by every carrier expressly excludes mold or was not intended to cover mold. Short of writing a pollution or environmental policy to specifically cover the mold, and short of creative coverage attorney finding some policy language to be vague and ambiguous, there is no coverage for this.

\$2,000

There should be no mark in any box. This is really a claim against a builder-developer that would be excluded under the D&O policy, even if the developer were on the board of directors. This would not be covered under the GL policy, because there is no claim for bodily injury or property damage. The defective steps do not fall within the standard definition of property damage.

\$4,000

The F&C box should have an I in it. This is not, however, a slam-dunk. First, the issued addressed in response to the \$500 question, above, should be reviewed and are applicable here. Second, this will probably be covered under the fidelity portion of the F&C policy as long as the definition of insured or the named agent endorsement is on the policy. If the policy includes crime coverage for theft, there could be coverage unless there is an exclusion for the property manager and his or her employees. It should also be noted that the property management company may have its own fidelity policy. Because this crime was committed by a management employee, the association should demand that a claim be made against the property manager's policy. The association should also seek indemnity against the property manager. As a side note, an association should never hire a property management company that does not carry an errors and omissions policy or its own fidelity/crime policy. This should be part of any management agreement.

\$8,000

There should be nothing in any box. If this claim was brought by an individual unit owner, it might be covered under the property manager's policy, but it is definitely not covered when the association sues the property management company for its acts, errors, or omissions. This is why the property management company should have its own errors and omissions coverage, in the event that the association sues the property management company. Second,

although most states do not give credence to a hold-harmless or indemnity provision that tries to exculpate a property manager from his or her own active negligence, the association should make sure that there is no provision in the management agreement that would exculpate the property management company against its own active negligence.

\$16,000

This is a very sensitive claim that is fraught with many practical, political, and legal issues. The claim itself could potentially give rise to other claims, depending on how the claim is responded to in the first instance. Preliminarily, depending on which D&O policy the association has, there could be a defense provided. The question is whether the policy purchased by the association provides a defense to non-monetary claims. This is a claim to remove a board member, not a claim seeking any type of monetary damages. Many of the D&O endorsements to various package policies do not provide coverage for non-monetary claims such as this. But the majority of D&O claims are non-monetary demands for action, namely that the association and its board do – or do not do – something. A claim like this, which is becoming more of a pressing issue throughout the country, could be very expensive to handle on behalf of the board and association. Without a policy that would provide the defense fees and costs, a claim of this type is virtually guaranteed to result in a special assessment to the association.

\$25,000

There should be no boxes checked. Some policies do not even cover developer-controlled boards. For those that do, the coverage would extend only to the developer's capacity as a board member and not to his or her capacity as a developer. Clearly, the marketing material was prepared during his tenure as a developer. Developers should take care to keep the conduct in the two capacities as mutually exclusive as possible to avoid potential confusion and coverage issues.

\$50,000

There should be a DI in the GL box and there should probably be a DI in the U box. Specifically, the higher limits could be at risk here. In addition, if coverage is insufficient in GL and umbrella policies, the association may need to issue an assessment to the individual unit owners. A savvy individual unit owner will have purchased a homeowner's/condo unit policy with the broadest and highest limit loss assessment coverage. If so, the HO box should be checked. In this case, the association should expect a defense from the GL carrier and should also anticipate a large enough judgment or settlement to enter the umbrella policy limits. But the broker gate could raise some issues. Most applications for GL and umbrella will require a warranty that the pool has a self-closing and locking gate. If it is determined that the association knew about the broker gate proper to the policy being issued, there could be a claim by the

insurer that it would have the policy had it known about the broken gate. This could lead to a rescission of the policies due to material misrepresentation. If the policy were rescinded, there would be no viable claim against the loss assessment coverage.

\$100,000

There should be a DI in the GL box for the claim by the unit owner against the president and the property manager for alleged unlawful entry and/or invasion or right of privacy. If the general liability policy includes personal injury coverage and the property manager is also an additional insurer under that policy, there could be potential defense and indemnification under the policy. It should be noted, however, that many package policies either do not have personal injury coverage, or exclude such coverage. In addition, a number of D&O policies have the personal injury coverages, but they would exclude the bodily injury claims. Most of the package policy D&O endorsements expressly exclude personal injury coverage. The property manager would not be covered by his own errors & omissions policy, if one exists, because of the bodily injury exclusion, and his own general liability policy, if any would not exist due to an off-premises exclusion.

\$250,000

Key here is that the unit owner is seeking coverage for the assessment and no other claims have been made. The association should have submitted a claim to its D&O carrier. If the D&O policy names the property manager as an additional insured and the policy provides employment practices liability insurance, a DI could have been placed in the D&O box. On the other hand, if the association had a package policy, the DI could not be placed in the box. Most package D&O policies do not include coverage for sexual harassment of employees, or other employment practices claims. Moreover, virtually none of them will add a property manager to the package policy. With respect to the claim by the unit owner for the assessment, since coverage was denied under the GL policy, there will not be coverage under the HO loss assessment coverage, unless it extends to D&O coverage.

\$500,000

There should be an I in the D&O box if the association has a stand-alone policy that does not exclude defense of the failure to maintain or obtain insurance. Virtually all D&O package policies will exclude the failure to maintain or obtain coverage. Even if the association is defended, no carrier will become the insurance that was not maintained or obtained. IN other words, the association and the board will be defended for its decision, but the insurance will not cover the loss that was not insured due to the board's alleged negligence. If the action was taken on behalf of the association against the property manager, there should be nothing in any of these boxes. No directors and officers policy will provide coverage for the property manager if any action taken by the association

against the property manager. In addition, no coverage would be available under any of the package policies that in the normal course would not include the property manager as an additional insured or within the definition of insured. Even if the property manager had an errors & omissions policy, there would be no coverage because the failure to maintain or obtain insurance would be excluded.

\$1 Million

If there was a stand-alone D&O policy, there will be a DI in the column, assuming that the D&O policy had personal injury coverage for the claim of false imprisonment. Under a package policy, this would be expressly excluded in most cases. There would also be DI for the claims by the board member of defamation under a stand-alone D&O, but most likely not under a package policy. There would be no coverage under the D&O or an association GL policy to compensate for the husband's hitting the individual who defamed his wife. However, if there were allegations of negligence in hitting the person, there may be coverage under the husband's homeowner's policy, if he has one. There could also be coverage is there was a claim against the board for choosing an insurance carrier that they should have known was not financially stable. This would be defense only, and there would be no coverage under the package policy.

Is It Time To Use Your Life Line?

Regardless of how solid you believe you insurance acumen may be, the complexity of both community associations and insurance products warrant the use of insurance professionals. Obtaining counsel form insurance processional rarely costs anything, and most insurance professionals understand that evaluating your insurance program and providing you with recommendations for coverage is part of their job. They should present you with the best available options and allow the association to make the best decision possible based on all the information provided. If the association makes a wrong decision, they should be protected by the business judgment rule and defended by a properly obtained directors and officers' liability policy.