CAI-NJ CHAPTER
INSRANCE AND RISK MANAGEMENT SEMINAR
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FLOODING OF UNIT BY HOT WATER HEATER

EXAMPLE OF INTERPLAY BETWEEN COMPETING INSURANCE POLICIES, "OTHER INSURANCE" CLAUSES AND THE IMPACT OF LANGUAGE IN GOVERNING DOCUMENTS

PROBLEM

In the summer of 2002, a unit owner's hot water heater burst during the night. The damages from the resulting flood were less than $10,000.00 which is the amount of the deductible of the association's insurance policy. The unit owner filed a claim with her homeowner's policy for the cost of replacement of carpeting. That claim was denied. The homeowner's insurance company, in denying the claim, cited portions of the governing documents which stated that the Association was obligated to obtain and maintain insurance covering common elements and repair to carpeting originally installed by the builder in the event of a casualty loss. The unit owner advised the association that the damaged carpeting was the original builder's carpeting installed approximately twenty years ago and demanded, in light of her insurance company's denial, that the association pay.

The Master Deed of the condominium association says that the Board of Trustees "shall be required" to obtain and maintain insurance for fire with broad form and extended coverage, insuring all the buildings containing the units and common elements including the fixtures, appliances **and carpeting initially installed in the units by the developer** but not including the painted or decorated services of interior walls, furniture, furnishings, personal property or contents. The Master Deed also says that all of the proceeds from such policy shall be payable to the Board of Trustees or its designee as an insurance trustee on behalf of all of the owners, co-owners and mortgagees of the units. The insurance trustee "shall be obligated" to apply the proceeds **as set forth in Article VI of the bylaws.**

Article VI of the bylaws says that in the event of casualty resulting in damage to the building amounting to less than two-thirds of the value of the condominium, "the net proceeds of any insurance collected shall be made available for the purposes of repair, restoration, reconstruction or replacement. Where the insurance indemnity is insufficient to cover the cost of repair, reconstruction, restoration or replacement, the new building's costs shall be paid by all of the owners directly affected by the damage, in proportion of the value of their respective dwelling units. . ."

1.) Must the association file a claim in light of the fact that there can be no insurance proceeds to collect since the claim is less than the deductible?

2.) Will making the claim negatively affect the association's rating with respect to premium calculation even if the outcome of filing the claim is a determination of "no coverage?"

3.) Can the unit owner's insurance carrier continue to refuse to pay for the carpeting if there is no formal "denial" of the claim by the association's carrier (because the association won't file the claim)?

ANALYSIS

The Association clearly has an obligation to carry insurance as stated above and in the event proceeds are received, must pay those proceeds as set forth in Article VI of its bylaws. Article VI, section 1, required that, in the event of casualty resulting in damage to the building, ". . .the net proceeds of any insurance collected shall be made available for the purposes of repair, restoration, reconstruction or replacement. . . . " Thus, where there are no net proceeds collected, there is nothing to make available to the unit owner. Article VI says where the insurance indemnity is insufficient, the cost of repair shall be paid by all of the owners directly affected. Therefore, assessment for the cost of carpeting was appropriately directed to the owner affected by the damage pursuant to section 1 of Article VI of the bylaws. The unit owner or the unit owner's homeowner's insurance would be responsible for the carpeting, not the association.

1 & 2). Underwriters assess past claim experiences of the association as one aspect of predicting future claim experiences. Because of the significant increases in premiums and the difficulty in obtaining insurance coverage where there are many claims, Boards are increasingly reluctant to make claims. Where the claim does not involve common elements and there is clearly no coverage because of the size of the claim relative to the deductible, there is no reason to submit a claim to the association's insurance carrier. In the event of all other coverage questions, the language of the governing documents should be consulted to ascertain the association's obligation to insure, if any, and obligations in the event of a shortfall in insurance, in addition to checking the policy language (or with your broker) in making a determination as to whether the association has an obligation to make a claim.

The association is governed by its master deed and/or declaration and bylaws. Its obligation to insure and make the proceeds available to the members is or should be set forth in those documents.

The Condominium Act at N.J.S.A.. 46:8B-14 requires the association to maintain:

(d) . . . insurance against loss by fire or other casualties normally covered under broad-form fire

and extended coverage insurance policies as written in this State, covering all common elements and all structural portions of the condominium property and the application of the proceeds of any such insurance to restoration of such common elements and structural portions if such restoration shall otherwise be required under the provisions of this act or the master deed or bylaws.

That section of the Condominium Act further requires:

(e) The maintenance of insurance against liability for personal injury and death for accidents occurring within the common elements whether limited or general and the defense of any actions brought by reason of injury or death to person, or damage to property occurring within such common elements and not arising by reason of any act or negligence of any individual unit owner.

Further, the Act provides:

(f) The master deed or bylaws may require the association to protect blanket mortgages, or unit owners and their mortgagees, as their respective interest may appear, under the policies of insurance provided under clauses (d) and (e) of this section, or against such risks with respect to any or all units, and may permit the assessment and collection from a unit owner of specific charges for insurance coverage applicable to his unit.

There is no statutory requirement for a homeowner's association to carry property insurance on structures.

The Condominium Act at N.J.S.A.46:8B-24 sets forth the obligations of condominium associations to rebuild in the event of damage or destruction to the property covered by insurance required to be maintained by the association. It further provides specifically, that "the unit owners directly affected shall be assessed on an equitable basis for any deficiency and shall share in any excess."

There is no statutory requirement for a homeowner's association to rebuild but there is usually language in the governing documents setting forth the obligations in the event of such circumstances.

3). The insurance policy between the unit owner and the insurance carrier is a contract. What is covered and what is not covered is a matter of interpreting the policy language. Conflicts involving "other insurance" issues arise primarily when the clauses involved are contradictory or in competition. The homeowner's insurance carrier in the PROBLEM presented tried to deny the claim without citing any language in its policy which justified the denial. In the PROBLEM set forth above, the unit owner's insurance carrier denied the claim on the grounds that the association's governing documents required the association to have

insurance coverage of a type that would include original carpeting as “covered property.” The homeowners’ insurance carrier did not consider the actual factual circumstances presented. The property damaged (original builders’ carpeting) was “covered property” under the policy as required by the governing documents but the size of the claim did not rise above the deductible threshold, so there could be no recovery under that policy. Setting the amounts of deductibles was a task left to the sound discretion of the Board according to the governing documents. Consideration of those circumstances should have been made by the homeowner’s insurer. If the language of the “other insurance” clause required there to be actual insurance proceeds available to its insured, then the denial was not justified. Courts will look to the particular terms of the relevant policies to try to resolve a conflict.

In every situation involving an insurance coverage dispute or claims of “other insurance” clauses, the specific language of the governing documents must be reviewed to ascertain the association’s obligation to insure. Associations must be sure, when purchasing insurance, that those obligations are met in the terms of the insurance policies that they are purchasing. Thereafter, in the event of loss, the specific language of the competing policies must be analyzed as to each issue in dispute.

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