

INSURANCE ADVISORY

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Tips for Reducing Insurance Claims – Part 2 of 2

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Many associations are also increasing their deductibles to eliminate claims for lesser amounts, and \$5,000 is now a common deductible. Associations that are required to follow Fannie Mae guidelines may have up to a \$10,000 deductible. However, this option makes sense, only if the association can shift the payment of deductibles onto the owners. It doesn't help, if an association must pay the deductible on every claim. Logically, the chances of having a water damage claim increase in proportion to the number of units in the association. If owners don't assume part of the risk by carrying their own insurance, associations will be unable to find or keep insurance.

Associations also need to implement some type of deductible "policy" before a claim occurs. Preferably this should be in the recorded declaration, since the courts give recorded covenants a presumption of validity. There are various options available for such policies, each having various pros and cons. They usually break down into variations of imposing the deductible either (1) on the person whose property was damaged in proportion to the dollar amount of the damage, or (2) on the owner who is at fault or whose component failed resulting in the damage.

Under the first option, if one owner (or the association) has 50% of the damage, that party would pay 50% of the deductible. The negative aspect of this option is that some owners may be forced to pay even if they had no responsibility for the component that failed. However, they can usually have it covered under their owner's policy. Under the second option, someone has to find a way to collect the deductible from the owner whose component produced the damage. Assume a plumbing leak in a second floor unit caused 80% of the damage in the unit below. That owner may get 80% of the insurance proceeds, but will be short in an amount equal to 80% of the deductible. It may require a lawsuit to force the second floor owner to pay the shortfall, and who will file it? Thus, a general preference is the equitable apportionment, because the downstairs owner will have to pay 80% of the deductible, but most could be covered under that owner's individual insurance. Even if the association's policy provides for an equitable apportionment of the deductible, it could also provide that the damaged owner has the right to sue another party for the deductible the damaged owner had to pay.

Another option is to see if the carrier will exclude just water damage claims, but not other causes of loss. However, there are few carriers that will offer such an endorsement. Also, as indicated in Part 1 of this advisory, if there is no coverage for water damage claims in owners' units, there is no coverage for water damage for any water damage claims in the common area either.

A similar option is to exclude certain property from coverage. The property most often damaged is wall, floor and ceiling coverings and drywall. If the association's carrier will write an endorsement to exclude these components from coverage, it would

eliminate a large number of claims. However, many insurance carriers will not write this exclusion. Also, if the association excludes coverage for these components, it is essentially self-insuring them in recreational facilities, common hallways and other common areas. Thus, these last two options should be reserved for extreme cases where the alternative may be obtaining no coverage at all.

Through a document amendment, owners could be required to obtain individual coverage to insure all attached components. The difficulty is trying to verify that each owner has actually done so. For every 52 units in any association, the association must seek verification an average of once a week throughout the year. The more units there are in an association, the more time-consuming verification becomes. When most associations have difficulty getting a majority of owners just to send in a proxy for the annual meeting, it could be a logistical nightmare to obtain verification for every owner.

While amendments to implement these options may require lender consent, a couple factors may help to overcome that requirement. Many newer documents require lender approval only by "eligible lenders." This means lenders who have notified the association that they want to vote on such amendments. During 23 years in this industry, I heard of only two owners whose lenders ever made such a request. Also, under Civil Code 1355 amendments may be adopted following either the governing document requirements or this statute. The statute states that an amendment requires approval by the percentage of the owners established by the governing documents, that the approval must be certified by the appropriate association officer and then recorded. The statute doesn't mention obtaining lender approval. So, an association can contend that a statute-adopted amendment doesn't require lender approval. The risk in this interpretation is that no court has been called on to endorse it. Thus, before an association relies on this language, it should take additional precautions, as indicated above, to minimize the risk of lenders being stuck with large losses, if an owner walks away from an uninsured claim.

In conclusion, the association's policies on insurance and deductibles really should make units fully habitable after catastrophic losses. However, providing coverage for every conceivable loss, regardless of amount, and for every owner's interior damage, is a recipe for an undesirable claims history and an inability to find an affordable policy and perhaps any policy at all. Absent a disastrous claims history, the best options for most associations are probably increasing deductibles to reduce the number of claims, shifting the deductible burden to owners for smaller, non-catastrophic claims, and providing an association-paid deductible for larger or catastrophic claims. However, before implementing any policy, each association should consult with its insurance professional and its legal counsel to make sure it is not inviting an unreasonable risk.