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Finger Pointing: Understanding the Relationship Between Insurance Coverage and Financial Responsibility in the Condominium Universe

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The Nightmare

You are an officer or director of a condominium association. It's 3:00 a.m. You are peacefully asleep in your condominium unit when another unit owner starts banging on your door. It seems the owner had heard the noise of a slight but persistent drip. As the owner walked into the unit's living room, a thin trail of water running from the ceiling down the wall to the floor was clearly visible. Before the owner could react, the ceiling opened up and a flood of water cascaded down over the owner's hardwood floors, furniture, and some priceless and frail antiques. When all was said and done, some 30 gallons of water had inundated the unit, warped the owner's floors, soaked the furniture, and destroyed the antiques. The owner's upstairs neighbor's hot water heater had failed. The owner demands to know what the condominium association is going to do about it.

This article investigates the operation of the North Carolina Unit Owners Act ("Chapter 47A") and the North Carolina Condominium Act ("Chapter 47C"), the role of a condominium's governing documents under Chapters 47A and 47C, the interaction between individual unit owner insurance policies and policies held by the condominium association, and the ultimate financial responsibility for damage to condominium units.

Identify Your Condominium Type

The threshold issue in answering any question about insurance coverage in the condominium context is to determine whether Chapter 47A or Chapter 47C applies to your condominium. Condominiums created on or before October 1, 1986 fall under Chapter 47A, while condominiums created after that date are governed by Chapter 47C.

This relatively simple determination is critical to evaluating insurance coverage issues, as these issues are treated quite differently under each Chapter.

Chapter 47A – The Unit Owners Act

The theme throughout Chapter 47A is deference to the governing documents of the condominium (typically, the "Declaration of Condominium" and the "Bylaws of the Condominium Association"). On more than one occasion, Chapter 47A simply refers the reader to the particular condominium's governing documents. The same is true with respect to the type and amounts of insurance coverage your Chapter 47A condominium

association is required to carry. Chapter 47A leaves it to your condominium's governing documents to determine what types of insurance and what amounts of insurance coverage the association must provide for the unit owners.

Chapter 47C – The Condominium Act

What Insurance Must Be Purchased By The Association?

Chapter 47C is far less deferential to the condominium's governing documents than Chapter 47A. Specifically, Chapter 47C directly addresses the types and amounts of coverage the association must carry. Chapter 47C requires that:

- To the extent reasonably available, the condominium association ***must*** acquire and maintain property insurance on the condominium's common elements, insuring against all risks of direct physical loss commonly insured against (such as fire, etc.), along with extended coverage perils;
- The amount of property/casualty coverage, after the application of the deductible, must be at least 80 percent of the replacement cost of the common elements (excluding items normally excluded from coverage) at the time the insurance is purchased (which must be reevaluated each time the insurance is renewed);
- To the extent reasonably available, the coverage must include the units, but need not include improvements and upgrades installed by a unit owner on the owner's own initiative; and,
- To the extent reasonably available, the condominium association ***must*** acquire and maintain liability insurance on the condominium's common elements in reasonable amounts, covering all occurrences commonly insured against such as death, bodily injury, and property damage arising out of, or in connection with, the use, ownership, or maintenance of the common elements.

What is meant by "reasonably available" is left unclear by Chapter 47C. Certainly, if coverage is just not available, it's not required, but what if it's available at an extraordinary cost? No cases have provided guidance in that situation. In any event, if the association determines that coverage is not reasonably available, the association must give its members written notice of that determination by hand-delivery or prepaid United States mail.

How Much Insurance Must Be Bought?

Chapter 47C mandates that condominium associations to which it is applicable must insure in an amount of no less than 80 percent of the replacement value of both the common elements and certain portions of the units. This is significant because 80 percent insurance is generally required to obtain full replacement cost coverage.

In the case of a covered loss where there is damage to a unit, the condominium association will likely claim coverage only to the extent of standard improvements to common elements and units, excluding damage to any particular upgraded item installed by the unit owner. For upgraded items, the unit owner must look to the owner's own property insurance. For example, if the unit was originally carpeted and the unit owner installs hardwood floors, the association's insurance most likely will cover only the cost to replace the floors with carpet.

What Must The Association Do In The Event Of A Covered Loss?

Chapter 47C also governs how and when a condominium association must act in the case of a covered loss. The general rule is that the association ***must*** repair any damage to covered property, or replace destroyed property, promptly. There are two main exceptions to this requirement. The association need not repair or

replace damage if:

- The condominium is terminated, or,
- Repair or replacement would be illegal under any state or local health or safety statute or ordinance.

Those circumstances are highly unusual and seldom come into play.

How Does The Owner's Policy Fit In?

The role of the owner's policy, often referred to as an "H06" policy, in the event of damage depends in large part on which Chapter governs the particular condominium.

In the case of Chapter 47A, the owner's policy can range from being the only source of coverage to being a mere supplement to the association's coverage, all depending on the terms of the condominium's governing documents.

By contrast, an owner's H06 policy in a condominium governed by Chapter 47C will likely cover only those tangential items purchased and installed by the unit owner such as furniture, special fixtures, upgraded flooring, etc. because, as mentioned above, the association's policy will cover damage to the basic unit itself.

What About The Costs?

No matter which Act governs your condominium or the type of insurance procured by your association, someone will have to bear the costs of not only the premiums, but also the deductible. Under Chapter 47A, the condominium's governing documents will dictate how the costs are distributed. If the governing documents do not dictate how the costs will be distributed, the expenses, whether a deductible or premiums, are most likely a common expense to be paid out of the association's general fund.

The same is true of premiums and deductibles in condominiums governed by Chapter 47C. However, it is not uncommon for Chapter 47C condominium governing documents to assign specific responsibility for deductibles. For example, your condominium Declaration may require that the affected owners, and only the affected owners, split responsibility for the deductible if a covered loss is claimed against the association's insurance policy. In other words, if two units are damaged by an event **AND** the association's policy covers the loss, the two unit owners would split the deductible. In other situations, the governing documents may provide that this deductible is a common expense which is paid out of the association's general fund and shared equally by all of the unit owners, including those not affected by an insured loss.

But It Was Their Fault!

Many condominium governing documents include provisions that exempt both the association and the affected unit owner from any liability if another unit owner actually causes the damage, through negligence, overt act, or otherwise. For example, if the owner of the water heater in our opening hypothetical tried to save plumbing bills by personally installing the water heater without benefit of a licensed plumber, but did not use the correct size or type of pipe (which turned out to be the cause of the failure), then the association's insurance company may have an avenue to deny coverage, and financial responsibility for the loss will shift to the culpable unit owner who may or may not have insurance coverage for the loss.

Sometimes, the governing documents will give the association the authority to assess or otherwise collect from the culpable unit owner the monies necessary to fix the damage to the other owner's unit. But, sometimes the association is given the authority to collect from negligent owners only for damage to the common elements, which leaves the downstairs unit owner to fight with the upstairs unit owner over who must pay for the damages to fixtures, furniture, and the like. Fault is always a significant question in property

damage matters, and one that requires sufficient investigation and analysis, whether there is insurance or not. If there is no fault and it is not a covered loss, as is often the case, then each party (upstairs unit, downstairs unit, and the condominium association) is individually responsible for paying the cost of repair to their own respective properties for which they hopefully have purchased their own insurance.

Conclusion

All condominium associations and unit owners are likely to experience some sort of damage to the common elements and the units at some point or another, be it caused by a hurricane, a hot water heater, or a misplaced charcoal briquette. Stuff happens. And, no matter the type of condominium or the insurance policies currently in place, all associations and unit owners alike should carefully evaluate the applicable law, the governing documents of the condominium, and their insurance policies to determine how best to either plan for future issues or address current ones.

But, remember, just because the condominium's governing documents require the association to insure the units, this does not mean the association is responsible for paying for the repairs to a unit if the loss is not covered by insurance. In such instances, the unit owner must bear the cost of such repairs.

As an officer or director of a condominium association, your life will be easier if you ensure not only that the association obtain all required insurance, but also, just as importantly, notify the unit owners what is and what is not covered by the association's policies so that they can prepare for loss. Then you have the ability to say "we warned you" if that becomes necessary.

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