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Condominium Water Leaks: Insurance Issues and Limitations of Liability

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We have heard the story before and will hear it again. Water leaks from one condominium unit into another and the offending unit owner will neither abate the problem nor repair the damages. The damaged unit owner looks to the Association to both stop the water leak and make the repairs. The initial instinct on the part of the Association may be to deny all responsibility on the grounds that it is a between unit problem that did not originate in the common elements. However, as we frequently advise our clients, the analysis may not be so simple.

In order to properly handle this common water leak claim, the Association must look to its recorded condominium instruments and the laws of its state to answer the following: Does the Association have a duty to mitigate damages during a water leak? Does the Association have a "right of entry" in the documents that will allow it to enter a unit in emergency situations to stop a water leak? Do the laws of the state and/or the recorded documents require the Association to report the leak to the master insurance policy regardless of fault and/or take on the repair work before the insurance funds are released? All of these questions must be answered by the Association to properly respond to a water leak claim.

In most instances, when water leaks from one unit into another, the leak has originated from a pipe or drain that services only one unit. Under the "maintenance and repair" section of most governing documents, an Association may not have a duty to repair damages that are caused from such a leak. Rather, the unit owner will likely be obligated to take on the repair work. However, while the Association may not have any responsibility under the "maintenance and repair" section of the recorded documents, it may have additional responsibilities in the insurance section of the recorded documents or the Association may have to intervene to mitigate damages when an offending unit owner refuses to do so.

In regards to insurance, when the damages to a unit amount to more than the insurance deductible amount (which will vary from association to association), the Association must typically still report the claim to the master insurance policy. The Maryland legislature pointed out recently that, under §11-114(c)(1) of the Maryland Condominium Act, all members of

an Association are beneficiaries of the master policy and, therefore, an Association must report a claim to the policy regardless of the determination of fault. Thus, under Maryland law, even if the water leak results from the carelessness or negligence of a unit owner, the claim must generally still be reported to the master policy. In fact, most recorded condominium instruments specifically state that the Association must obtain a master policy that will cover claims that exceed the deductible, regardless of fault. Of course, not all damages are covered under a master insurance policy.

Typically, the master policy will cover damages that exceed the deductible to the drywall, floors, carpeting and other fixtures initially installed by the developer but will not cover "betterments and improvements" of the unit owners (i.e., alterations made by the owners after purchase from the developer) or the personal property of the unit owner. It is also important to note that most master policies do not cover damages that result from ground water or flooding. Therefore, an Association should always check with the agent for the master policy to make sure that all claimed damages in excess of the deductible are, in fact, covered under the master policy. In addition, Associations should encourage (or require, if possible) all owners to obtain HO-6 insurance policies that will cover owners' personal belongings and/or other items excluded from coverage under the master policy.

Once a claim is reported to the Master Policy, the deductible can then be assessed to the "at fault" owner. You might ask - how will the Association assess a deductible when the claim involves a between unit dispute in which the Association has had no real involvement? This is where the Association's ability to inspect the units and assess liability will come into play. Most recorded condominium documents provide authority on the part of the Board to enter units (after notice) to inspect and determine the cause of a water leak. Some recorded documents go even further and allow for the Association to take immediate action in cases of emergency to enter a unit and stop the water leak, if possible. Some recorded documents also set forth the Association's ability to make repairs and assess the repair costs back to the offending unit owner. If the recorded documents for the Association do not clearly spell out the Association's authority to inspect and/or assess liability for the deductible, we recommend that the Board of Directors adopt a policy resolution that restates the applicable language of the recorded documents and that also details exactly how the language of the recorded documents will be applied when there is a unit to unit water leak. As described more fully below, the Policy Resolution should recite the recorded document language that requires an owner to immediately report water leaks and the resolution should include the Association's rights and responsibilities to investigate such water leaks per the recorded condominium documents.

Of course, after the deductible is assessed to the "at fault" owner, it must then be collected. As the Association is the holder of the master policy, it is typically the Association's responsibility to pursue collection of the insurance deductible from the offending owner. We generally do not recommend that the Association charge the damaged owner with

collecting the master policy deductible from the offending owner. Rather, the Association should provide the costs of repair to the damaged owner and then pursue the offending owner for the master policy deductible. However, if a loss is less than the master policy deductible then the collection effort would be pursued by the damaged owner or their insurer.

Given that water leaks are one of the most commonly reported maintenance issues, we recommend that our clients have on hand a policy resolution to address in detail exactly how a reported water leak will be handled and the division of responsibility for maintenance and repair as set forth in the recorded condominium documents. The policy resolution should incorporate the insurance requirements in the recorded documents and the statutory requirements for the applicable jurisdiction. The resolutions that we draft for our clients contain specific guidelines that track the language of the recorded condominium documents for the following aspects of any water leak incident: water leak reporting requirements on the part of owners; authority for access and mitigation of damages in emergency situations; authority for access to inspect and assign liability after reasonable notice is given; authority to assign insurance deductible amounts to offending owners; and the specific responsibility for handling the repair work after a water leak. If your Association is interested in such a resolution, we would be happy to prepare one for you. Please contact one of the attorneys in our office to discuss.

While at first glance it may seem that an Association may have responsibility for claims for unit damages that originate from the common elements, many Associations overlook "limitation of liability" or "exculpatory" clauses within their recorded condominium documents that may allow them to avoid responsibility for damages from water leaks. A typical limitation of liability clause in the recorded documents will read as follows: "The Council shall not be liable for any failure of any services to be obtained by the Council or paid for out of the common expense funds, or for injury or damage to person or property caused by the elements or by the co-owner of any condominium apartment unit, or any other person, or resulting from electricity, water, snow or ice which may leak or flow from any portion of the common elements or from any wire, pipe, drain, conduit, appliance or equipment…"

While the Association must typically still report a claim for unit damages that exceeds the master policy deductible to the master policy for coverage, the Association may be able to avoid responsibility for deductible amounts or non-covered amounts with the enforcement of such an exculpatory clause. The use of the exculpatory clause in the condominium's recorded documents is an effective tool that many associations do not employ, and such clauses have been upheld by the Virginia Supreme Court. In the matter of Nido v. Ocean Owners' Council, 237 Va. 664; 378 S.E.2d 837 (1989), the Virginia Supreme Court held that such clauses are not contrary to public policy as all owners are put on notice of the limitations of liability when they purchase a home and receive a copy of the recorded Declaration and Bylaws for the Association. In order to bring this clause to the membership's attention, we recommend

that the Board adopt a policy resolution that restates any exculpatory clause from the recorded condominium documents. This policy would also highlight the Association's intent to rely on the recorded exculpatory clause in the event that unit damages originate from certain common element conditions. The recorded exculpatory clause can also be restated in a more general policy resolution that addresses the handling of water leaks, as described above.

If you have any questions about the water damage and insurance issues discussed in this memorandum, please contact any of our Community Association attorneys and we would be glad to help.