



POOLED MASTER HAZARD INSURANCE POLICIES MAY VIOLATE INSURANCE OBLIGATIONS IN CONDOMINIUM PROJECT CC&Rs

Does your Association's master fire and casualty, or hazard, insurance policy comply with the insurance requirements in your Association's CC&Rs? If the answer is "no" and you are a member of the Association's Board of Directors, then you could be exposing both the Association and yourself to liability for breach of duty under the CC&Rs. If the answer is "I don't know," then you need to find out as part of your due diligence.

Many CC&Rs for attached condominium projects contain language obligating the Association to maintain casualty, flood and liability insurance coverage meeting the requirements for condominium projects established by Fannie Mae and other secondary market, government backed private mortgage insurance companies. These entities buy loans from other lenders and insure them. This language is placed in the CC&Rs initially so that the project can be Fannie Mae approved so that prospective purchasers can more easily obtain purchase money financing. This makes the units more marketable from a lending standpoint.

The insurance provision in the CC&Rs may state that Fannie Mae guidelines for fire and casualty insurance must be met:

- (a) *so long as* Fannie Mae is a mortgagee or owner of a condominium within the project;
- (b) *except* to the extent such coverage is not available or has been waived in writing by Fannie Mae;
- (c) *if deemed reasonable* by the Board; or
- (d) *if reasonably available*

If your Association's CC&Rs contain the qualifying language in item (a), you need to make sure that the Association's master hazard insurance policy complies with Fannie Mae guidelines if the mortgage on any one unit in the project has been sold to Fannie Mae, or if Fannie Mae is an owner (through foreclosure) of a unit in the project. This can be difficult to ascertain, as mortgages get packaged together and sold frequently. If your CC&Rs contain the exception in item (b), then you are off the hook only if the coverage is unavailable or Fannie Mae waives the requirement in writing. If your Association's CC&Rs allow more leeway (such as the language in items (c) and (d)), then the Board can make a reasonable business judgment decision, after comparing different policies, as to whether it is reasonable from a cost and coverage standpoint for the Association to comply with Fannie Mae guidelines with respect to the master hazard insurance policy.

However, the language in some association's CC&Rs do not contain any exceptions or qualifications and merely obligate the Association to maintain fire and casualty insurance consistent with Fannie Mae guidelines. If this is the case, then unless the Association amends the CC&Rs to delete this requirement, the master fire and casualty insurance policy must meet Fannie Mae guidelines for insurance.

There is a fairly recent Fannie Mae requirement set forth in the Fannie Mae Announcement 08-34, dated December 16, 2008 that ***"a blanket policy that covers multiple unaffiliated condominium associations or projects"*** is unacceptable for master or blanket project insurance for condominiums.

This requirement has caused a stir in the industry due to the popularity of *pooled insurance policies for condominium projects*, especially with high rise condominium projects. Pooled policies are policies shared by multiple unaffiliated condominium projects - exactly what Fannie Mae has declared unacceptable.

These pooled policies are often very desirable because the premiums can be much lower and the coverage significantly greater. While it sounds like a win-win, there are various concerns that an association's board of directors should be aware of and address, including without limitation the following:

- Will the Association run afoul of the Association's governing documents by not complying with Fannie Mae guidelines for insurance?
- How many other associations are in the pool and where are they located?
- What happens if a major hazard occurs impacting all the associations in the pool? Can the insurer guarantee that insurance proceeds necessary to cover the loss will be available to the Association?
- Is the Association the holder or primary insured under the pooled policy?
- Will the Association be entitled to advance notice if a change is going to be made to the policy?
- Will the carrier give the Association any written guarantee that the policy it proposes to sell the Association meets the Association's insurance obligations with respect to its master hazard insurance in its CC&Rs (including any requirement that the policy be consistent with Fannie Mae guidelines)?

Because the Board members likely do not have the expertise in insurance, Fannie Mae guidelines for insurance, or in interpreting the Association's insurance requirements, the Board should retain the advice of an expert. Under the Business Judgment Rule, codified at California Corporations Code Section 7231(a):

A director shall perform the duties of a director . . . in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, *including reasonable inquiry*, as an ordinarily prudent person in a like position would use under similar circumstances. (Emphasis added)

This is the standard against which all of a director's actions and decisions will be measured. Directors who perform their director duties in a way that measures up to the Business Judgment Rule will be protected against personal liability to the association and its members. To avail themselves of the protection afforded by the Business Judgment Rule, it is vital that directors be able to explain the reasoning behind any action or decision they make as a director, and demonstrate that their reasoning satisfies the requirements of the Business Judgment Rule. This includes a decision on master hazard liability insurance coverage for the condominium project.

Recognizing that directors may not have command of all specialized knowledge necessary to make every decision for the association, Section 7231(b) of the Corporations Code allows a director to rely on other people who possess the applicable knowledge or expertise. Section 7231(b) of the Corporations Code provides that:

In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:

- (1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented;
- (2) Counsel, independent accountants or other persons as to matters which the director believes to be within such person's professional or expert competence;
or
- (3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence, so long as, in any such case, the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted.

If directors perform their duties in accordance with Section 7231(a) (*i.e.*, the Business Judgment Rule) and rely on expert advice and opinions pursuant to Section 7231(b), then Section 7231(c) provides that such directors will "have no liability based upon any alleged failure to discharge [their] obligations as a director."

Accordingly, prior to making a decision to obtain pooled master hazard insurance coverage for the Association, the Board should seek the advice of a coverage attorney or other such qualified expert (independent from the Association's current or proposed carrier) who can review the Association's CC&Rs with respect to insurance requirements, and determine, objectively, whether the proposed insurance policy meets such requirements. The expert's report or conclusion can then be relied upon by the Board in making its decision. The Board will be following the Business Judgment Rule and will be protected from personal liability, even if its ultimate decision is later proved to be the wrong decision.

Board members of condominium projects must think carefully and do their homework prior to agreeing to obtain a pooled master fire and casualty insurance policy for the Association. Just because it sounds good (lower premiums, more coverage) doesn't mean it's the right policy for the Association.

CASE SUMMARIES

Evan Carolyn v. Orange Park Community Association 177 Cal. App. 4th (September 21, 2009)

Association's common area recreational trails, to which members of the general public have access, are NOT areas of "public accommodation" subject to the Americans with Disabilities Act.

FACTS:

Orange Park Community Association (OPCA) is a planned unit development in the City of Orange. Within the community are a system of recreational trails that connect to a larger system of trails, some of which are maintained by other private associations and others maintained by governmental entities. Several years ago, citing safety concerns, the OPCA installed barriers at trail entry points to prevent vehicles from using the trails. *At no time were members of the general public denied access to the trails.* Plaintiff, who is neither an owner nor resident of the OPCA community, filed suit against OPCA claiming the trails were a public accommodation subject to the accessibility requirements of Title III of the Americans with Disabilities Act (ADA) and state disability discrimination laws, and that the barriers prevented her from riding her horse drawn carriage on the trails within OPCA.

TRIAL COURT'S DECISION: In favor of Defendant.

Based upon the Trial Court's finding that the trails were *not* a place of public accommodation within the definition of the ADA and state laws, the Trial Court found no violation as a matter of law and granted summary judgment in favor of the Association. Plaintiff appealed.

APPELLATE COURT'S DECISION: Affirmed the Trial Court.

Title III of the ADA prohibits discrimination on the basis of disability in “*any place of public accommodation.*” To assist in determining what constitutes a place of “public accommodation,” the ADA lists 12 categories of public accommodation, some of which are privately owned facilities, such as parks, zoos, bowling alleys, and other places of recreation.

The only issue before the Appellate Court was whether the recreational common areas within a common interest development are places of public accommodation subject to the ADA. However, the Appellate Court analyzed this issue in light of the following specific facts of the case: (1) the recreational area is a fenced trail on association common area; (2) architectural barriers prevented access to the trails by vehicles; (3) the trails are linked to a larger system of privately and publicly owned trails; (4) trails are accessible to the general public and the association never took any action to preclude members of the general public from using the trails; and (5) the association did not charge fees to members of the public for using the trails or do anything to otherwise commercially exploit their trails.

In reaching its decision that OPCA's trails were *not* places of public accommodation under the ADA, the Appellate Court considered several other prior cases.

The Appellate Court also relied on a Department of Justice (DOJ) letter, in response to a citizen's request for information as to the ADA's applicability to a clubhouse at a housing development. In this letter, the DOJ found that if a clubhouse in a residential housing complex is intended for the exclusive use of residents and their guests, then it is not a place of public accommodation subject to the accessibility requirements of Title III of the ADA. However, if the clubhouse is made available to the general public for rental or use, the clubhouse would be a place of public accommodation. (DOJ, Office on the Americans with Disabilities Act, 202-PL-118, September 11, 1992)

Based upon these prior decisions, the Appellate Court in the OPCA case held that the OPCA's trails are *not* public accommodations under either the ADA or California law. The Appellate Court noted that “OPCA's private trails do not transform into places of public accommodations merely because OPCA does not actively exclude members of the public from using the trails.” The Appellate Court relied on the fact that most of the categories listed in the ADA (i.e., zoos, golf courses, bowling alleys, amusement parks) are public places designed and intended to provide services and/or goods to members of the public in exchange for the payment of money or to promote the good will of the community. Because OPCA's trails were built for its own members and OPCA does not advertise nor charge for the public's use of the trails, the Appellate Court found the trails to be an amenity provided for OPCA's members only, and not a place of public accommodation.

The Appellate Court noted, however, that recreational common areas in common interest developments can be classified as public accommodations in appropriate circumstances. For example, if a fee is charged for the use of an association's recreational facilities by members of the general public or an outside entity, then the recreational facilities will be a public accommodation subject to the accessibility requirements of Title III of the ADA.

The Appellate Court also distinguished this case, which addressed only places of public accommodation and federal and state accessibility requirements, from the federal and state fair housing laws that are not dependent upon a finding of public accommodation.

COMMENT: The Appellate Court in this case strongly relied on the unique and particular facts of the OPCA trails in reaching its conclusion that the trails were not a place of public accommodation. Therefore, this case reinforces the point that ADA issues and inquiries are very fact-specific and must be reviewed individually on a case-by-case basis to decide if the ADA or other disability discrimination laws apply to a particular set of circumstances.

Creekridge Townhome Owners Association v. REO Roofing Co., et al.
177 Cal. App. 4th 251 (September 1, 2009)

A complaint by one unit of a moisture related problem and loose roof tiles was insufficient to cause an association to conduct further investigation of potential defects; thus, the statute of limitations did not bar association's lawsuit against roofing company for construction defect.

FACTS:

Creekridge Townhome Owners Association is a townhome development comprised of 11 buildings with 61 units. In early 1997, the Association reroofed all 11 buildings in the community. Not long after, in June 1997, one owner complained of water moisture in her second story bedroom and several broken roof tiles. No other roof problems were detected or complained of until the winter of 2003, during which the Association detected numerous roof leaks. In the spring of 2004, the Association hired a roofing consultant, who found multiple causes for the leaks and multiple roof defects. On June 18, 2004, the Association filed a lawsuit against the roofing company for breach of warranty, breach of contract, and negligence based upon the company's reroofing job in 1997.

TRIAL COURT'S DECISION: In favor of Defendant.

The Trial Court granted summary judgment in favor of defendant roofing company based upon the expiration of the statute of limitations.

APPELLATE COURT'S DECISION: Reversed the Trial Court.

In reaching its decision, the Appellate Court considered whether the roof defects were patent construction defects or latent construction defects, which affect the running of the statute of limitations period. A four (4) year statute of limitations for a "patent" construction defect begins running when the construction is substantially completed and the average consumer, during the course of a reasonable inspection, would discover the defect. (Code of Civil Procedure Section 337.1(a)(1)) In this case, the Court relied on the fact that the inspector hired by the Association in 2003 found multiple defects in the 1997 reroofing project but found that these defects would not be readily apparent to a lay person. Accordingly, the Appellate Court found that one complaint about a moisture problem and a few broken tiles was insufficient to find a patent construction defect that would have triggered the running of the 4 year statute of limitations in 1997.

The Appellate Court also considered whether the roof defects were “latent” construction defects, which are not apparent by reasonable inspection. In the case of a latent construction defect, a cause of action for injury to real property must be brought within three (3) years or, for breach of contract, must be brought within four (4) years, but in any event must be brought within ten (10) years of substantial completion of the work. (Code of Civil Procedure Section 337.15) The running of the limitations period for latent construction defects begins when the plaintiff suspects or reasonably should suspect that someone has done something wrong to plaintiff causing injury.

Again, the Appellate Court found that the one moisture related problem and discovery of only a few loose roof tiles, involving only one unit, was not “sufficiently appreciable damage to give a reasonable person notice that remedies must be pursued” to trigger the running of the statute of limitations period for a latent defect. In reaching its decision, the Court compared the facts of this case to another case in which a latent construction defect was found. However, in that case, there were heavy rains, multiple units had leaked, and there were other roof, deck and stairway leaks and problems, which would have prompted further inquiry as to other damage, thereby triggering the running of the applicable statute of limitations. (See *Landale -Cameron Court, Inc. v. Ahonen* (2007) 155 Cal.App.4th 1401, 1408))

The Court concluded by stating that “[i]f we were to find in favor of defendant [roofing company] that would force property owner associations across the state to conduct extensive investigations for possible construction defects based on any report of a small problem. This could prove very expensive for the association and would often be futile. We decline to impose such a burden.”

COMMENT: If an association receives multiple complaints or otherwise detects or becomes aware of the same or similar construction-related problems or potential defects, an association should consider itself on notice that the damage or injury suffered may give rise to a lawsuit, triggering the statute of limitations as to when such lawsuit may be filed. In such event, legal counsel should be consulted to assist in preserving the association’s rights.

Starlight Ridge South Homeowners Association v. Hunter-Bloor
177 Cal. App. 4th 440 (September 3, 2009)

Association NOT required to maintain V-ditch on owner’s lot because CC&Rs require owner to maintain all drainage systems and devices on her lot, even though V-ditch was located in Association-maintained landscape maintenance area.

FACTS:

Starlight Ridge is a planned unit development in Temecula, California. Within the community are “landscape maintenance areas” described and depicted in the Association’s CC&Rs. One of the landscape maintenance areas runs behind the entire portion of plaintiff/lot owner’s rear yard. A concrete drainage channel (“V-ditch”) also runs across owner’s lot entirely within an Association-maintained landscape maintenance area.

Pursuant to the CC&Rs, each owner is required to maintain and repair “the drainage system and devices, if any, located on his Lot.” The CC&Rs also provide that the Association is obligated to maintain the landscape maintenance areas, defined as “all plantings, planted trees, shrubs, irrigation systems, walls, sidewalks and other landscaping improvements. . . .”

The Association claimed that the more specific drainage maintenance provision controlled over the more general landscape maintenance area provisions, whereas the owner claimed that the Association’s maintenance obligations as to the landscape maintenance areas were more specific and controlling than another provision of the CC&Rs, requiring the owners to only maintain existing drainage patterns set by grading of the lots.

TRIAL COURT’S DECISION: In favor of owners.

Based upon the Trial Court’s interpretation of the CC&Rs, the Trial Court granted summary judgment in favor of the owner and the Association appealed.

APPELLATE COURT’S DECISION: Reversed the Trial Court.

The Court of Appeal first looked at the *plain meaning* of the CC&Rs and found them to be inconsistent. “Where two provisions appear to cover the same matter, and are inconsistent, the more specific provision controls over the general provision.” (177 Cal.App.4th at 447, citing Code of Civil Procedure Section 1859) Both parties argued that one provision was more general and that another provision was more specific than the other. To resolve the conflict, the Court of Appeal relied on the past practice and history of how the Association interpreted and applied these provisions and the general purpose of the V-ditches and landscape maintenance areas in the community.

The Association produced evidence that during the 20-year history of the Association, it had enforced the obligation of the owners to maintain and repair drainage devices existing on their lots, including the V-ditch. The only difference was that the portion of the V-ditch at issue is located in a landscape maintenance area. However, evidence also showed that the landscape maintenance areas were primarily comprised of small areas bordering the entrances of the community and were only aesthetic in nature, whereas the owners’ duties regarding drainage affect the fundamental integrity of each lot and the development as a whole.

In reaching its decision, the Court of Appeal further relied on its finding that the purpose of the V-ditch, as a storm water drainage device, was of fundamental importance to the community as a whole, which was found to be altogether different than the aesthetic purposes of the landscape maintenance areas. The Court of Appeal considered the fact that the V-ditches crossed over almost all the lots in the community, and that the owner was seeking a virtual windfall by trying to get the other owners, through assessments, to pay for the Association’s maintenance of the V-ditch located on her lot simply because it just so happened to be located in a landscape maintenance area.

Accordingly, the Court of Appeal found that the more specific provisions of the owners' obligation to maintain drainage facilities on their lots prevailed over the more general provisions governing the Association's obligation to maintain the landscape maintenance areas. As such, the Association was not obligated to maintain the V-ditch although located in an Association-maintained landscape maintenance area.

COMMENT: As demonstrated in this case, an association's past practice is often looked at if a provision in the governing documents is ambiguous. It is therefore important for associations to be consistent in their interpretations of their governing documents and how they are applied and enforced as to association members.



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HARLE, JANICS & KANNEN
575 Anton Boulevard, Suite 460
Costa Mesa, CA 92626

Telephone: (714) 429-0600
Facsimile: (714) 429-0699
E-mail: hjklaw@hjklawfirm.com
Website: www.hjklawfirm.com

Jakob S. Harle

graduated *magna cum laude* from the University of California, Los Angeles in 1984 and earned his law degree from the UCLA School of Law in 1987, where he served as Managing Editor of the *UCLA Law Review*. He is a past director and past president of the Orange County Regional Chapter of CAI.

Kathleen A. Janics

received both a bachelors and a masters degree from the University of Southern California, in 1983 and 1984, respectively. In 1990, she graduated *cum laude* from the University of San Diego School of Law where she served as an intern for the Honorable Richard Huffman at the Fourth District Court of Appeals, and as an associate editor of the *Journal of Contemporary Legal Issues*. She is a past director of the Orange County Regional Chapter of CAI.

Karen A. Kannen

received a bachelor of science degree from Cornell University in 1985 and graduated *cum laude* from the University of San Diego School of Law in 1990. While attending law school, Ms. Kannen was a member of the *San Diego Law Review*. She is also admitted to the Colorado Bar.

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a law corporation

575 Anton Boulevard, Suite 460
Costa Mesa, CA 92626

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