COMMUNITY UPDATE™

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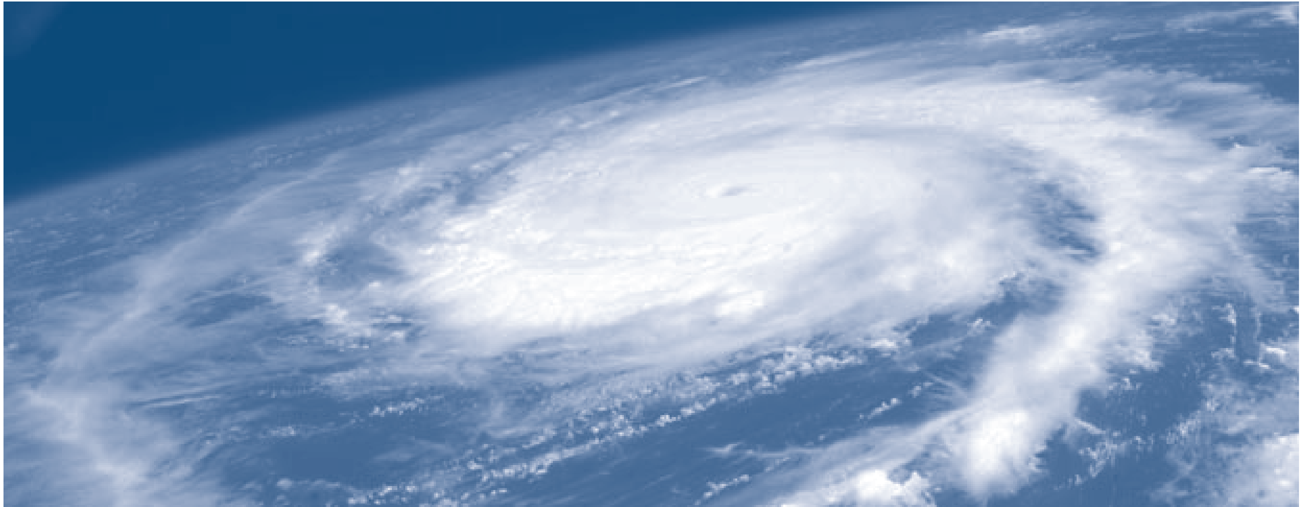

FEDERAL COURT JURY AWARDS ASSOCIATION 8.1 MILLION DOLLARS IN HURRICANE WILMA INSURANCE CLAIM

It's been close to two (2) years since Hurricane Wilma tore through Palm Beach County. Two (2) long years of inspections, engineering evaluations, bidding, selecting contractors, working with permit officials, construction debris, noise, dust and inconvenience. Two (2) long years of paying large assessments, incurring debt and questioning whether any of the reconstruction expenses would be reimbursed by the insurance company providing coverage to the association. For the 378 owners of the Chalfonte condominium in Boca Raton, Florida, a Federal Court Jury answered that question in the positive by returning a verdict for approximately $8.1 million for damages. The Association is represented by Becker & Poliakoff's team of experienced litigation attorneys in the dispute, led by Dan Rosenbaum, the Managing Shareholder of the Firm's West Palm Beach office.

Chalfonte is a luxury condominium situated on the Ocean, consisting of two 21-story residential buildings, recreational facilities and improvements. The property was insured by QBE Insurance Corporation, an Australian Company, for close to $70 million dollars for property damage, with an additional $6.5 million in law and ordinance coverage. Since the eyewall of the storm passed directly over the condominium, damage to the common elements and interiors, including the roofs, interior drywall/walls, generator, garage doors, sliding glass doors, elevators, windows, the satellite system and personal property of the Association (furniture and furnishings) was substantial. The damages were reported to the insurance company immediately after the storm which occurred in October, 2005.

The insurance company failed to adjust the claim in a timely manner. In fact, the Association didn't receive a formal adjustment (estimate) of the damages from QBE until after it filed suit in Federal Court. QBE claimed that Chalfonte exaggerated its damage by Hurricane Wilma and that many of the damaged items were excluded from coverage under the policy due to wear and tear, corrosion and other matters. Although Chalfonte spent approximately $12 million on hurricane related repairs, QBE determined the actual damage to be only about $460,000, well under the $1.6 million policy deductible.

Damage to windows and sliding glass doors was responsible for the bulk of the costs sustained by the Association. An analysis performed by a Certified General Contractor determined that more than seventy-five percent (75%) of the sliding glass windows and doors were severely damaged, either blown out

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entirely or damaged beyond repair – those components had to be replaced. However, the local ordinances require building permits to be approved by a Community Appearance Board which partially decides to approve or reject permit applications based upon whether the completed work would maintain the city's high quality image. The local ordinances specifically required multiple building communities to have a unity of character and design, with the goal of creating a harmonious appearance. Replacing the vast majority of the windows and sliding glass doors, while leaving the original, non-damaged doors and windows in their previous condition, would be obviously noticeable and create an inconsistent appearance. Thus, the Association, based upon the advice of the experts consulted and the codes in place, proceeded to replace all the exterior windows and sliding glass doors, not only those beyond repair.

QBE disputed the Association's contention that all the windows and sliding glass doors had to be replaced. The insurance company maintained the position that only some of these items were actually broken as a result of the hurricane and that the majority of the glass needed to be replaced anyway since the buildings were almost thirty (30) years old and thus worn out due to wear and tear. The Association was able to present testimony from reliable experts, not only the Certified General Contractor and licensed Structural Engineer that examined the buildings after the storm, but from professionals that had consulted with the Association in the past, attesting to the fact that the windows/sliding glass doors could not be repaired. The history of maintenance records was extremely helpful in the analysis of the damages, but QBE's representatives still did not agree that all windows would have to be replaced, did not agree that all of the damages were from the storm and would not include these expenses in its adjustment of the claim.

Consequently, the Association filed suit in Federal Court and went to trial on three (3) separate counts. The first count asked the Court to issue a Declaratory Judgment upholding the validity of the contract and entitlement to coverage for the damages sustained from the storm. The second count was for Breach of Contract as a result of the failure to provide coverage. The last count was likewise a count for Breach of Contract based upon a claim of breach of the implied warranty of good faith and fair dealing.

The insurance company attempted to strike or dismiss the third count several times, claiming that Florida law does not provide a separate cause of action for a breach of contract claim based upon a violation of the implied warranty of good faith and fair dealing. The Association's attorneys successfully defended the Association's right to maintain such a claim, defeating both a Motion for Summary Judgment and a Motion in Limine. QBE argued to the Court that Count III of the Complaint constituted an action for "bad faith", a cause of action available at common law and by Section 624.155, Florida Statutes. The Becker & Poliakoff team convinced the Court that the covenant of good faith and fair dealing is implied in every contract, in order to protect the parties' reasonable contractual expectations. The Court agreed that the Association was entitled to a good faith handling of its claim and the discretion afforded to QBE in the insurance contract could not be exercised in such a way as to thwart the insured's reasonable expectations.

Moreover, Chalfonte's attorneys noticed that the form of the insurance contract, even though it had been approved by the Department of Insurance, failed to conform to Section 627.701, Florida Statutes, which requires any policy containing a separate hurricane deductible to include certain statements in boldface type in a certain font size.

On Wednesday, August 29, 2007 after a trial that lasted two weeks, a Federal Court jury returned a verdict finding that QBE Insurance Corporation breached its insurance contract and ordered the company to pay the Chalfonte Condominium Apartments Association, Inc. approximately $8.1 million dollars in damages. The federal jury determined that QBE breached its contract, breached the implied warranty of good faith and fair dealing and determined that QBE's form policy, as it relates to the hurricane deductibles, did not comply with the disclosure requirements of Section 627, Florida Statutes. QBE will be responsible to pay approximately $1,000,000 in pre-judgment interest and prevailing party attorney fees and costs to Chalfonte.

The federal jury's findings will allow Chalfonte to pursue another lawsuit against QBE for bad faith claims handling practices, pursuant to Section 624.155, Florida Statutes.

"This is a huge development for the Associations, perhaps hundreds of them out there in Florida, that have not received an equitable adjustment of their losses from the last two active hurricane seasons," said Dan Rosenbaum. "This is the second case involving QBE in which the Court ruled the insurer has an implied warranty of good faith and fair dealing. I think the message to QBE is that they cannot treat the insured that way. They can't beat them down and break them down."

The Chalfonte verdict is a reminder to all community associations of the critical importance of the association conducting a complete and thorough post-casualty inspection and inventory of the entire property, instead of relying on the individual owners to inspect their own units and document their own damages; and the importance of contacting the right professionals to get advice about handling and documenting the claim and addressing the insurance issues. Documenting all of the damages caused by the casualty with photographs, video and detailed records is imperative to protecting the association's interests as is a careful review of the insurance contract itself. If you believe your claim has not been adjusted fairly, it's not too late. Supplemental claims are still being processed by the major insurers, especially as a result of all the damages that only became known after the initial analysis was done and the claim paid. ■

TACKLING BANKRUPTCY ISSUES

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In today's economy an increasing number of individuals are dealing with their own financial situation by opting to liquidate their assets under Chapter 7 or reorganize under Chapter 11 or 13 of the Bankruptcy Code. This article is intended to address some of the issues that face an association when one of its members decides to file for bankruptcy.

Whether an association's judgement is subject to being avoided as a judicial lien on debtor's homestead?

Generally, Florida's constitution protects its residents' homestead (the home in which they reside) from being impaired by judicial liens (liens obtained by judgment).

If an association obtained a judgment against a unit owner/ homeowner, could that judgment be avoided by the debtor as a judicially lien impairing the individual's homestead? The answer is no.

In one case, the Court held that a judgment requiring Chapter 7 debtors to remove a pool and concrete deck that they had built in violation of restrictive covenants governing the appearance of homes in a community was in the nature of a personal mandate, and did not give rise to a "judicial lien," of the kind which debtors could avoid as allegedly impairing their homestead exemption rights. Similarly, in another case, a homeowners' association obtained a pre-petition (before bankruptcy) judgment against a Chapter 7 debtor-homeowner for unpaid monthly assessments, late fees, interest, and attorney fees and costs. The debtor subsequently moved to avoid the lien on the ground that it impaired her homestead exemption. The Court held that the nature of the lien was a security interest, despite being in the form of a final judgment, and thus, it was not an avoidable "judicial lien." Although the judgment in favor of the creditor-homeowners' association for unpaid assessments appeared at first blush to be a "lien obtained by judgment" within the Bankruptcy Code's definition of a judicial lien, substantively, the lien stemmed from a security interest through the parties' declaration of covenants and, thus, was in the nature of a security interest.

Are post-petition homeowners' association assessments discharged?

The primary reason people file for bankruptcy is to obtain a discharge (or wipe out) of their pre-bankruptcy debts. Normally however, that discharge does not apply to debts incurred after the filing of the bankruptcy. However, homeowners' associations face a unique dilemma that other creditors don't face, and this has led to a split amongst the Courts. This problem arises because on the one hand the debtor will be living in his home after the bankruptcy filing and continuing to accrue monthly maintenance and other expenses due to the association, but on the other hand the association's declarations which give rise to the ability to assert this debt in the first place was incurred pre-petition and it has been argued should be discharged.

For example, in one case from the Middle District of Florida, the Court, ruling on a homeowners' association motion to compel a Chapter 7 debtor to reaffirm, redeem, or surrender, held that a debtor's obligation for post-petition homeowner association assessments would survive his Chapter 7 discharge, as a condition of his continued ownership of the lot that was the subject to these assessments, regardless of whether the debtor reaffirmed the debt.

In that case, the Judge notes that there are actually three different lines of case authority on the dischargeability of post-petition assessments to community associations. Florida cases have been split on the issue. One line of authority has held that post-petition assessments are non-dischargeable because the obligation to pay assessments arises from a covenant running with the land. A second line of authority has held that post-petition assessments are dischargeable because they arose from a pre-petition contract. A third line has taken a compromise position that post-petition assessments are dischargeable unless the debtor resided in or leased the unit.

The judge in that case noted that in 1994, Congress attempted to resolve this split of authority by enacting Bankruptcy Code Section 523(a)(16), which provides:

A discharge... does not discharge an individual debtor from any debt–

> (16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has **condominium ownership or in a share of a cooperative housing corporation**, but only if such fee or assessment is payable for a period during which–
>
> (A) the debtor physically occupied a dwelling unit in the **condominium or cooperative project**; or
>
> (B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case. (Emphasis added.)

While this amendment may have solved the problem for condominium and cooperative associations, unfortunately, direct reference to homeowners' associations is missing from the 1994 version of the statute, although the legislative history seems to imply coverage for homeowners' associations.

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See 140 Cong. Rec. H10770 (daily ed. October 4, 1994) ("this Section amends Section 523(a) of the Bankruptcy Code to except from discharge those fees that become due to condominiums, cooperatives, or similar membership associations after the filing of a petition..."). On the other hand, however, another Court has since extensively reviewed the legislative history of Section 523(a)(16), including Senate floor comments and concluded that Section 523(a)(16) did not extend to homeowners' associations.

Fortunately this issue was resolved by the Bankruptcy Reform Act of 2005 which amended Section 523(a)(16) to read:

A discharge... does not discharge an individual debtor from any debt–

> (16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, or a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;
>
> Thus resolving the issue for homeowners' association communities and eliminating factual questions as to whether the debtor still resides in the property or received rental income during the relevant period of time.

Are post-petition association assessments entitled to an administrative priority claim in bankruptcy?

In order to assist the debtor through the bankruptcy process and assist in the administration of the estate, the Bankruptcy Code allows for the priority payment of certain administrative expenses of the debtor's estate incurred post-petition over those of other unsecured creditors so long as they are an actual and necessary cost of preserving the estate. In a 1989 case out of Tennessee, involving a Florida condominium, the condominium association moved for allowance, as an administrative expense, of the maintenance and condominium assessment fees accruing post-petition against condominium units owned by the debtor. The Bankruptcy Court in Tennessee, held that a claim for maintenance and condominium assessment fees asserted by a condominium association was not entitled to an "administrative expense" priority as an "actual" and "necessary" cost of preserving the estate, absent a showing that the assessments were actually utilized to preserve and benefit the individual condominium units owned by the debtor, and not the condominium community as whole.

Whether an association can record or perfect post-petition its lien for past due assessments without seeking relief from the automatic stay to do so?

In a 1986 case from the Middle District of Florida, the Chapter 11 debtor moved to hold a condominium association in contempt for violation of the automatic stay, and the association moved to allow the filing of a lien. The Court held that the post-petition recordation of a claim of lien on a debtor's condominium did not relate back to any time pre-petition, and violated the automatic stay, because, under Florida law (as it was written at the time), a lien was only effective when recorded.

The Court found that on one hand, under the Bankruptcy Code, the post-petition recordation of a mechanic's lien for work performed pre-petition relates back to time pre-petition, under Florida law, and the lien defeats or has priority over the rights of a trustee or a debtor holding status of a hypothetical lien creditor under the Bankruptcy Code, so that the filing of a lien would be permissible post-petition for the purpose of perfecting a mechanic's lien. However, also under the Bankruptcy Code, Court found that the post-recordation filing of liens, which, in contrast to mechanic's liens, are effective only upon recordation under Florida law (as it was written at that time), did not relate back to any time pre-petition, and therefore violates the automatic stay.

In response to that case, the Florida Legislature in 1990 amended Fla. Stat. §718.116 by adding subsection (5) to state that a condominium association lien to secure the payment of assessments is effective from and shall relate back to the recording of the original declaration of condominium, or, in the case of lien on a parcel located in a phase condominium, the last to occur of the recording of the original declaration or amendment thereto creating the parcel.

Now, after the 1990 amendments creating §718.116(5), condominium associations do not need to seek stay relief to record and perfect their pre-petition lien rights, and are treated as other statutory lien holders, such as materialmen and mechanics' lien holders, in their ability to pursue this remedy unimpeded by the automatic stay. However, since homeowners' associations are not covered by a similarly applicable statute, homeowners' associations would be covered under the old case law holding that such liens did not relate back to any time pre-petition, and therefore an attempt to prefect them post-petition violates the automatic stay.

Conclusion

The interplay between bankruptcy and association law creates other interesting and complex issues for associations in enforcing their rights. If you have any issues that arise as a result of one of your association's members or vendors having filed bankruptcy, please contact your Becker & Poliakoff association lawyer, and ask them to speak with me so that we can together address the issue and develop a strategy to best protect your association's rights in bankruptcy. ■

MAINTENANCE V. ALTERATION

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You may know that making a "material alteration" to the Common Elements requires a vote of the members of the Association. A material alteration is defined as a change in use, form or function. Chapters 718 and 719, Florida Statutes, state that if the Association Governing Documents do not specify a procedure for approving material alterations, "75 percent of the total voting interests of the association must approve the alteration..."

You may also know that the Board of Directors has a duty to operate and maintain the Common Elements of the Association. This duty to maintain is not discretionary, and no owner vote is required.

There are some activities that are clearly "material alterations," such as putting in a swimming pool on the Common Elements. This would obviously require unit owner approval. There are other activities that clearly fall into the "maintenance" category, like replacing a deteriorating roof. This activity would be undertaken at the direction of the Board of Directors, and no owner approval would be required.

What about activities that are not so clearly defined? For example, is it a material alteration to replace carpet with tile? Replacing the old carpet with new carpet would certainly be considered "maintenance." Replacing carpet with tile could arguably be considered a change in "form," and thus, a material alteration; but what if the Board decided that tile would last longer, and require less ongoing maintenance, than carpet? Could the replacement of carpet with tile then be considered maintenance, and therefore not require a vote of the owners?

Since the inception of the arbitration requirements in the Condominium Act, there have been a number of significant decisions in the Florida Arbitration Cases regarding what constitutes a material alteration which would require the approval of the membership, and what falls within the scope of the Board's authority. These decisions are helpful to us in this analysis, and include:

1. Kreitman v. The Decoplage Condominium Association, Inc., Case No. 98-3495 (September 14, 1999) – In this case, the Board replaced the common elements acoustical ceiling tiles with drywall and the ceramic floor tiles with marble. The Arbitrator found that this replacement fell within the scope of the Board's maintenance authority, and did not require unit owner approval. In this case, the Arbitrator found that the drywall was a more durable, cost-effective ceiling material, and determined that the existing ceramic floor tiles could not be cleaned. The Association in that case was not required to replace a material that had performed poorly, when there was an alternative that was comparable in function.

2. Midman v. Sun Valley East Condominium Association, Inc., Case No. 99-0537 (August 26, 1999) – In this case, a deteriorated river rock deck around the pool was replaced with paver bricks, and the Arbitrator found that it was a necessary repair, not a material alteration, and within the scope of the Board's authority, since the paver bricks required less maintenance and lasted longer than the river rock decking.

3. A.N. Inc. v. Seaplace Association, Inc., Case No. 98-4251 (November 19, 1998) – The Association undertook substantial window replacement. The Arbitrator found that, even if the replacement of the windows changed the exterior building appearance and was a material alteration to the common elements, the alteration would not require a vote of the owners since the replacement of the windows was reasonably necessary to maintain and protect the common elements, despite the fact that the new windows were a substantial upgrade to the existing windows.

4. In another case involving the replacement of a river rock pool deck with paver bricks, Bronstein v. Hills of Inverrary Condominium, Inc., Case No. 94-0147 (March 24, 1995), the installation of the paver bricks was held not to be an improvement because it did not change the size of the decking, but merely the type of surface. In that particular case, the Board had determined that the river rock decking needed repair or replacement, and the Arbitrator held that it fell within the scope of the Board's authority to maintain, repair and replace the common elements, and no vote of the unit owners was necessary.

The rationale in all of these decisions seems to focus on the necessity of replacing the element at issue. On the other hand, in George v. Beach Club Villas Condominium Association, Inc., 833 So.2d 813 (Fla. 3d DCA 2002), replacement of cedar shingled roof mansards with terra cotta tiles was held to be a material alteration, requiring a vote of the unit owners, even though the replacement of the shingles was necessary to maintain the roof, and the terra cotta tiles cost about half as much as the cedar shingles; the Court stated that the change constituted a "substantial and material alteration in appearance." Id., at 819 and therefore could not be approved by Board vote alone. ■

INFRINGEMENT OF EASEMENT – A CASE NOTE

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Sand Lake Residence LLC v. Ogilvie, 2007 WL776605 (Fla. 5th DCA 2007).

FACTS: Landowners who held easement providing for ingress and egress across permanent access road on adjoining property (Sand Lake) sued to remove the speed bumps installed by Sand Lake, and require that Sand Lake leave an electronic gate that Sand Lake installed but that was not described in the easement agreement open. The easement agreement provided a non-exclusive perpetual easement in favor of the adjoining landowners over Sand Lake's access road. The agreement contemplated the installation of one electronic gate but Sand Lake installed a second electronic gate and placed speed bumps across the permanent access road. Sand Lake provided the adjoining owners several means to pass through the front gate, which was not contemplated in the agreement. The landowners could open the gate by using a single button remote, by entering a personal access code in the gate's keypad, by calling Sand Lake's office during business hours, by calling their own cell phone numbers from the gate and buzzing themselves in. If the owners wished to admit a guest or a delivery person, they were permitted to either provide that person with their personal access code, or utilize any of the other options for entry. The Trial Court held that both the speed bumps and the gate unreasonably interfered with the adjoining landowners' easement rights. Sand Lake did not appeal the ruling with regard to the speed bumps, but did appeal the ruling with regard to the gate.

ISSUE: Does an electronic gate with all the options mentioned above unreasonably interfere with the easement rights of the owners?

HOLDING: No.

RATIONALE: If the document granting the easement does not address the issue, whether or not a gate may be erected depends on whether the gate would unreasonably interfere with the easement holders' rights. The Appellate Court distinguished one prior community association case precluding the erection of a gate by holding that the gate here was much more easy to access because it could be opened from a distance by anyone in all of the above described ways. It is unclear how many of these access options are necessary to obtain the same result in light of the prior cases which have held that other gates without all of these access options do unreasonably interfere with easement rights. ■

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