



A Wake Up Call for all Community Associations

Homeowners Awarded \$30.7 Million in Lawsuit Against Northwest Indiana Homeowners Association

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Unfortunately, after insuring over 75,000 community associations nationwide, a too common attitude seen amongst community associations and their boards is the notion that: It will never happen in our community. What community associations seem to ignore is the reality that although they may be a residential community, the management of the community is no different than the management of any “business.” At the end of the day, whether it is a property owners association, a condominium association or some other type of a common interest development, directors and officers of a community association have a fiduciary obligation. An inherent element of this obligation is that “ignorance is not bliss.”

A recent Indiana case highlights the need for associations to diligently prepare for worse case scenarios. In March 2011, a jury found a Northwest Indiana homeowners association 100% at fault for the drowning death of one child and personal injury of two children, awarding the family \$30.7 million. In March 2001, four children were playing on a lake located at the Lakes of the Four Seasons community. The ice gave way near the shoreline. One child drowned, another child received traumatic brain injury, and a third child witnessed the drowning and injury of his two brothers.

Typically, this type of accident is considered an act of God, and a plaintiff cannot recover damages for injuries incurred. However, this situation was different because the jury found the accident was not caused by an act of God, but rather by a man-made condition. An overflow crib, which regulates water flow from a nearby dam and circulates water, caused the water to flow and thin the ice in the spot where the children were playing. Therefore, the jury found that the thinning of the ice was the direct cause of the Plaintiff’s

injury and subsequently found the Association 100% liable for the injuries incurred by the small children. Unfortunately, there were no warnings, barriers, or other safety equipment near the lake to indicate that there was a hidden danger. Associations should take heed to review the safety measures regarding lakes, ponds, and dams, and take precautions to ensure that any association bodies of water are in line with those standards. Associations may have an affirmative duty to warn trespassers of the potential dangers associated with ponds, lakes or dams. Therefore, your association may need to consider adding warning signs, barriers and/or safety equipment near bodies of water as recommended.

We can all agree to disagree regarding the judgment rendered by the jury in the Lakes of the Four Seasons case. If you review the internet and the blogs nationwide discussing this case and its result, very few people would have bet the farm on this outcome. On the other hand, no experienced trial attorney I know will ever tell you they have seen it all, or that they can ever predict how a jury will come down. A factor that all readers should keep in mind is that the association in this case had \$6 million in insurance — you do the math — there is a \$24 million dollar excess judgment.

Community Association Risk Management

What the Lakes of the Four Seasons case should do is ring the bell of community associations. A community association is a common interest development where individual property owners have common interests to one degree or another with the other property owners. The nature and size of the common interests run the range of a monument sign at the entrance of a community to extensive greenbelts, lakes, dams, roads, and all forms of recreational amenities. A community association requires management, and that is the role of the board of directors. Accordingly, the board of



directors by definition is the community association's risk manager.

As the risk manager of the community association, the board of directors must:

- Understand the nature and characteristics of the association's physical elements;
- Understand the association's governing documents and the laws that regulate the community association, and the exposures its physical elements present;
- Understand what needs to be done to comply with all the laws and governing documents; and
- Understand the needs for disaster planning.

As the community association Risk Manager, before any board members reading this article immediately submit a resignation letter due to the overwhelming feeling you may have, you should understand that as a board member you are not expected to know and understand all the elements of risk management. Rather, what you need to understand is what you do not know and elicit the assistance of community association professionals. Virtually every community in the country has community association professionals.

The professionals an association should probably have on speed dial include the following:

- Reserve Specialist (as all associations should have a properly done and properly funded reserve study as the keystone to a risk management plan.
- Community Association Attorney — do not pay to have the wheel recreated. These attorneys know the issues, know the laws and understand the idiosyncrasies of the community association. Contrary to the normal notion that laws, rules and regulations follow common sense, these professionals know how to navigate the sometimes craziness and impracticalities of laws.
- Community Association Accountants — whether 10 units or 1,000 units, an association needs its books and

finances supervised by an accountant.

- Community Association Insurance Professional — like with any business, there are unique elements to a community association and insurance products that are uniquely developed for community associations. Your local neighborhood agent may not have the experience.
- Emergency and Restoration Specialists — who do you call at 2 a.m. when the building is burning or the flood is rising.
- Community Manager — The manager is critical and worth his or her weight in gold if you have the right professional.

However, the majority of associations nationwide are self managed and do not have the luxury of a community manager.

What must be kept in mind is that a Board's fiduciary obligation includes the requirement that they avoid "self-dealing" and "the appearance of impropriety." This is critical in the use and selection of community association professionals.

The key issue for the association is to do a "risk management" audit. The audit should include a review of the association's governing documents to make sure they are current and comply with current laws. The association can comply with its governing documents, but if they are not accurate, the best of intentions mean nothing. A community association attorney can probably do this type of review very economically. Very often the genesis of governing documents was a developer who really did not understand how the association would develop.

There is no short cut to having a good reserve study for an association. In relation to the Lakes of the Four Season's case, a reserve study is a method of understanding the community's exposures whether it be a lake with latent dangers, an unfenced pool, sick trees



or the like. Very often, counsel or management companies, without having a baseline to work from, may not be able to help the association comply with safety issues. Many dangers and exposures may arise from elements of the association that need repair. Again, these are items that are monitored in a reserve study.

Most associations do not consider Disaster Recovery Plans when they think of their homeowners association. Why do we do this for our business, but we do not do it for our homes, family and community? It is like doing a “will.” People just are afraid to address things that are uncomfortable, or they have the notion we opened up with that it will never happen to them. Who is in charge in a disaster? Who do you call? Who pays for displacement? Unfortunately, there are no short cuts.

Furthermore, your association should consider other potential hazards in your community. Any condition that poses a hazard which may be invisible to the naked eye, such as the overflow crib in the case just discussed, should be evaluated. Also, an association should take owner complaints about potential safety hazards seriously. You should never assume that nothing bad will happen, that the association will not be held liable, or that your insurance will cover any and all losses.

This past year, some Indiana legislators attempted to pass a bill that would require homeowners associations to erect barriers around retention ponds, so it is clear that regulation of these bodies of water is becoming a public concern that every homeowners association should consider. Sometimes for all of us, community associations included, the best defense to legislators is a good offense. The associations that create risk management plans to avoid unfortunate situations can help obviate more legislation which too often creates unintended consequences.

Insurance is also critical to the risk management equation as this is how it is funded in many instances. Without insurance, how could the Lakes of the Four Seasons be able to defend the lawsuit against them for the circumstance where an element of risk management in the community failed? Once all the elements of the risk management plan are in place, then it is time for the insurance/ specialist to come in and build the protection to be a backstop for the risk management plan.

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