Memorandum on Allocations of Common Expenses

FROM: Jim Smith, Reporter

TO: Subcommittee to Consider Allocations of Common Expenses: Bill Breetz, Carl Lisman, Barry Hawkins, Barry Nekritz, Howard Swibel, Dave Ramsey

DATE: Dec. 28, 2020

This Subcommittee is reviewing the allocation of common expenses to unit owners under Section 3-115. The two main issues identified so far are (1) charging unit owners for common expenses that benefit fewer than all owners, Section 3-115(d), and (2) charging unit owners for common expenses related to their own behavior, Section 3-115(g). At the end of this memorandum, Appendix 1 contains all of the November 2020 draft of Section 3-115 with Reporter's Notes.

I. The Benefit Rule

The Drafting Committee extensively discussed the "benefit rule" with the expression of opposing viewpoints at our April 2020 and November 2020 meetings, reaching no resolution. In addition to the scope of the "benefits fewer than all" provision, a related issue is the method of disclosure of this provision to unit owners. For example, the act might require the disclosure of details in the declaration.

The present text of the benefit rule is contained in Section 3-115(c), which provides:

> To the extent required by the declaration:
>
> (1) a common expense associated with the maintenance, repair, or replacement of a limited common element must be assessed against the units to which that limited common element is assigned, equally, or in any other proportion the declaration provides;
>
> (2) a common expense benefiting fewer than all of the units or their owners may be assessed exclusively against the units or unit owners benefitted; and
>
> (3) the costs of insurance must be assessed in proportion to risk, and the costs of utilities must be assessed in proportion to usage.

The proposed revision in the November 2020 draft divides this subsection (c) into new subsections (c), (d), and (e), dealing with limited common elements (paragraph 1), the benefit rule (paragraph 2), and insurance and utilities (paragraph 3), respectively. In the November draft, no change in substance is intended for the limited common element and insurance and utilities provisions.

The proposed revision to the benefit rule in the November 2020 draft states:

> (d) The declaration may provide that common expenses benefiting fewer than all of the units must be assessed exclusively against the units benefitted, but only if the declaration specifies which common expense is to be assessed

exclusively and which units are subject to the assessment. If the declaration so provides, the assessment must be made in accordance with the allocation specified in the declaration.

The intent of the proposed revision is to limit the discretion of the executive board to decide on a case-by-case basis which common expenses ought to be charged to fewer than all of the unit owners. The proposed revision is based on the proposition that there should be a strong norm that common expenses ought to be allocated to all units and that departure from the norm is justified only for exceptional circumstances.

II. The Bad Behavior Rule

Issues concerning the "bad behavior" rule came up for the first time at November 2020 meeting of the Drafting Committee, prompted by input provided by Commissioner Barry Hawkins. Barry provided a long critique of Section 3-115(d), circulated as part of the November 2020 draft of Section 3-115 (his comments appear in Appendix 1 at pp. 4-8 infra).

The bad behavior rule is presently located in Section 3-115(e), which the November 2020 draft renumbers as Section 3-115(g). It states:

> (g) If damage to a unit or other part of the common interest community, or if any other common expense is caused by the willful misconduct or gross negligence of any unit owner or a guest or invitee of a unit owner, the association may assess that expense exclusively against that owner's unit, even if the association maintains insurance with respect to that damage or common expense.

Barry Hawkins suggests that the Connecticut statute has language that may be useful. Connecticut, a UCIOA jurisdiction, modified this provision, effective in 2010, to provide:

> (e) If any common expense is caused by the wilful misconduct, failure to comply with a written maintenance standard promulgated by the association or gross negligence of any unit owner or tenant or a guest or invitee of a unit owner or tenant, the association may, after notice and hearing, assess the portion of that common expense in excess of any insurance proceeds received by the association under its insurance policy, whether that portion results from the application of a deductible or otherwise, exclusively against that owner's unit.

Conn. Gen. Stat. Ann. § 47-257(e).

Appendix 1

SECTION 3-115. ASSESSMENTS.

(a) Until the association makes a common expense assessment, the declarant shall pay all common expenses. After ~~an assessment has been made by the association, assessments must be made~~ the association makes its first assessment, it shall make periodic common expense assessments at least annually, based on a budget adopted at least annually by the association.

(b) Except for assessments under subsections (c)~~, (d), and (e)~~ through (g)**,** or as otherwise provided in this [act], all common expenses must be assessed against all the units in accordance with the allocations set forth in the declaration pursuant to Section 2-107(a) and (b). The association may charge interest on any past due assessment or portion thereof at the rate established by the association, not exceeding [18] percent per year.

(c) ~~To the extent required by the~~ The declaration may provide for~~:~~

~~(1) a~~ the assessment of common expenses associated with the maintenance, repair, or replacement of a limited common element ~~must be assessed~~ against the units to which ~~that~~ the limited common element is assigned~~,~~. The declaration may provide that the assessment be made equally~~,~~ against the units or in any other proportion ~~the declaration provides;~~.

~~(2)~~ (d) ~~a~~ The declaration may provide that common expenses benefiting fewer than all of the units ~~or their owners may~~ must be assessed exclusively against the units ~~or unit owners~~ benefitted~~; and~~, but only if the declaration specifies which common expense is to be assessed exclusively and which units are subject to the assessment. If the declaration so provides, the assessment must be made in accordance with the allocation specified in the declaration.

Reporter's Note (10/23)

Barry Hawkins writes:

> After considerable thought and re-reading of subsection (d) I have come to like it better and better and do not think it needs any major surgery. As I now read it, it would appear to apply primarily to ongoing maintenance and repairs or replacements. As long as there are no big surprises for the unit owner I think it makes sense to allocate financial responsibility to those unit owners whose units include features different in kind from that of other owners. Everybody would be on an even playing field since the features triggering different allocations from the standard (whether based upon value, square footage or any other measuring tool) would be disclosed specifically and the buyer could choose to buy or not buy depending upon that factor among others. I think that works well in on going maintenance and perhaps less well in the event of allocating cost of repairing or replacing features harmed by some loss event because of the interplay of insurance and causation and the difficulty of advance disclosure of the many unexpected events which could have been allocated differently with perfect foresight. None the less and subject to my subsequent comments on subsection (g) I think it works and is an elegant solution to a difficult problem.

~~(3)~~ (e) To the extent required by the declaration, the costs of insurance must be assessed in proportion to risk, and the costs of utilities must be assessed in proportion to usage.

~~(d)~~ (f) Assessments to pay a judgment against the association may be made only against the units in the common interest community at the time the judgment was entered, in proportion to their common expense liabilities.

~~(e)~~ (g) If damage to a unit or other part of the common interest community, or if any other common expense is caused by the willful misconduct or gross negligence of any unit owner or a guest or invitee of a unit owner, the association may assess that expense exclusively against that owner's unit, even if the association maintains insurance with respect to that damage or common expense.

Reporter's Note (10/23)

Barry Hawkins writes:

> Now I turn to subsection (g) and that is a horse of different color. I think we got it wrong in 2008 and now it needs to be corrected. As I will elaborate on later I think we saw the problem in our 2010 deliberations in Connecticut and modified

what was then 3-115(e) to its present format in Conn. Gen Statutes Section 47-257. I propose that (g) be discussed as part of your committee's agenda and have concluded that it be substantially re-written to more closely track 47-257. In hindsight I think we came closer to the solution in 2010 and now regret that we did not then tackle amending CIOA to implement that fi'.

Subsection (e) as it was identified in 1982 CIOA was maintained in the original formulation from 1982 through the substantial amendments in 1994. It was apparently modified in 2008 and that is where I think we went wrong. The original formula allowed the association to directly surcharge the unit owner for misconduct resulting in a loss. The language did not deal with the issue of whether or not there was insurance coverage for the loss and the formula has no explanatory commentary.

I submit that the formulation and absence of commentary result from the fact that almost all property insurance policies exclude from coverage damages resulting from the intentional bad acts of the insured. This limitation of liability is identical between master policies covering multiple units and standalone single homes. It would not be a surprise or unfair for a unit owner to find that their policy would not pay for intentional bad acts (read "misconduct").

In a common interest community of course there is a need to reconcile the fact that unit owners are insured but they are also not individually responsible for purchasing and paying for the policy premium. To avoid an unfair result in such a community we also provided for mandatory insurance Waiver of subrogation rights to make sure that a unit owners misconduct would not defeat the claims of other unit owners for damages To their units and the association on behalf of all owners to achieve the same result for damages to common elements resulting from misconduct of a unit owner. Section 3-113 sets forth the provisions needed to reflect the unique needs of unit owners in a multi-family ownership situation and it did it quite nicely in a manner which was consistent with 3-115. These two subsections worked reasonably well from 1983-2008 when I think we left the tracks inadvertently but with good intentions.

In 2008 section 3-115(e) was amended to add the word willful as a modifier to misconduct (a change of no substance I think since willful is inherently an implied feature of misconduct and this changes the standard not at all) and much more importantly added the troubling standard of gross negligence to the conduct that would allow the association to visit the entire cost of repairing damages upon the errant unit owner and even worse added the concept that this would be done whether or not there was any insurance coverage for the conduct and the resulting damages.

The origin of these unfortunate changes was probably based upon the factors discussed in the commentary to section 3-113 of the 2008 CIOA text. The changes made to 3-115(e) are described in the accompanying commentary as

being made at least in part to resolve the issues described in the 2008 commentary to 3-113 as needing solution. Unfortunately they do not directly nor adequately address the very real problems of high deductibles, lack of incentives for unit owners to act carefully with respect to maintaining common elements, and lack of incentives for unit owners not to file numerous small claims against the master policy thus raising the costs of premiums for all as well as leading to higher deductible amounts resulting in associations effectively having to self insure many such smaller claims. The raising of insurance premium cost and higher deductibles results of course in all unit owners paying the resulting cost of such lack of incentives.

Although the 2008 commentary acknowledges the difficulty of selecting fair and adequate alternatives it appears to have been mesmerized by the prospect of passing on the costs of many tort claims by expanding upon the concept of assigning fault to unit owners having tort claims and blithely passing it on to the unit owners individual property owners insurance carriers to pay for the repair or replacement of damages which had formerly been the responsibility of the master policy Carrier.

Accordingly 3-115(e) was modified to allow the association to decide whether the damages resulted from ordinary or gross negligence and if the latter, to allocate the total cost of repair or replacement to the unit owner. Presumably the association would not receive much resistance since that owner could then submit the claim to his unit insurance carrier paying only the much more modest deductible charged by that unit carrier. In effect and despite the existence of provisions in 3-113 making it clear that the master policy was to provide primary insurance and the unit policy only secondary, this flim flam game depended upon the unit policy carrier accepting the decision of the association that the tort was one of gross negligence and therefor the tort was not an insured event under the master policy.

It did not take unit policy insurers long to realize that this was actually a three card Monte scheme with unit owner responsibility for negligence being cleverly passed on to the unit carrier. The unit carriers have of course pushed back with higher premium costs, larger deductibles and sometimes complex litigation claims. Many association lawyers, including me, have advised their clients to encourage unit owners to obtain unit property damage insurance coverage from the same carrier that writes the master policy, making the carrier agnostic as to the characterization of the tort as gross or simple negligence. Either way the carrier must pay and there is in reality no change in the incentives to be given to change unit owner conduct. I would submit that a scheme of coverage based upon an absence of incentives and a pull the wool over the carriers eyes is not a sound policy to be promoted by the ULC.

Even in the absence of a “hiding the ball “scheme of passing liability for payment on to the unit policy insuror there are a number of sound policy reasons not to add

"fault" to decide whether a unit owner should pay for the cost of repair or replacement resulting from an accident. First, ordinary insurance policies on single family homes cover accident damage claims so that is the ordinary expectation of the property owner. In order to vary that expected and normal result there should be a sound rationale based upon some unique circumstance of common ownership that justifies a difference in result.

There are some differences of course such as the association pays the premium based upon mandatory payments from all owners and the policy prohibits any subrogation claims against the unit owners based upon their status as owners. This payment difference does lessen the incentive of an owner not to file meritless or numerous small claims since that conduct would raise the cost of premiums for all owners and no individual owner is likely to risk having their coverage threatened by non renewal or premium surcharge levied only against them. If the conduct of claims is poorly managed by one or more unit owners all owners will bear that risk jointly.

Secondly the distinctions between simple and gross negligence have been perplexing and difficult for jurists and juries alike for many decades. Saddling this distinction on multi family structures only as opposed to single family homes is a real step backwards and likely to be favored only by litigators who are paid to explore the often subtle differences.

Third , since the initial decision about whether to submit a claim to the master insurance policy or not to do so will fall to the associations board (which has a strong incentive to avoid raising the expenses of all owners either because of high deductible or future premium increases or both) the unhappy owner may or may not be able to rely upon a unit policy carrier (and least have to pay that deductible alone) or to sue the Board for using gross negligence as a reason for non submission. If the latter the unit owner would then have the burden of proving that he or she was not grossly negligent as difficult and expensive as that may be.

Finally the incentives arguably justifying this unfair choice of not seeking payment under already available insurance coverage paid for by all owners are not the least expensive and most efficient way to provide proper incentives.

The problem of multiple small or frivolous claims can be met by applying a de minimus standard to all claims below a reasonable minimum at which if meritorious the association would self insure by paying to repair the damage with funds of all owners through the common charges. Claims could be denied as not being meritorious by the Board But only after notice and opportunity for the unit owner to be heard.

In addition to misconduct as a trigger for unit owner liability the same high standard could also be applied to a unit owner who has violated a duly publicized written standard of maintenance such as maintaining heat in temporarily

unoccupied units to prevent frozen pipe damage, not exchanging water heaters or laundry hoses beyond x years. Again after notice and hearing such conduct would be deemed equal to misconduct triggering individual liability.

Finally the desirable standard should probably articulate whether the Prohibited conduct of a unit owner warrants individual responsibility for all damages including deductibles or whether the standard should be all such expenditure (including deductible) after payment of all insurance proceeds. That decision may have to be made also in contemplation of the fact that damages to other units or common areas resulting from such conduct may be beyond the resources of a single unit owner and you may not want to deprive the association from access to the insuror's presumably deeper pockets.

As noted above the choices made in 2010 by the Connecticut council reviewing the 2008 act, as reflected in Section 47-257 of the Conn Gen Statutes would serve as a useful starting point in improving the policy decisions still reflected in what is now Section 3-115(g) of the Act being drafted. It is now time to correct our earlier error.

(h) The association may adopt a policy that allows all unit owners to prepay assessments at a reasonable discount specified in the policy.

~~(f)~~ (i) If common expense liabilities are reallocated pursuant to Section 1-107, 2-106(d), 2-110, or 2-113(b), common expense assessments and any ~~instalment thereof~~ installment of the assessment not yet due must be recalculated in accordance with the reallocated common expense liabilities.

Reporter's Notes

1. The Study Committee Report (topic # 3) asks: "Under what circumstances may the Association's Executive Board assess common expenses against some but not all units in a common interest community?" The Drafting Committee at its January 2020 meeting discussed the issue. The consensus was that sharing common expenses among all unit owners should be a strong norm, that the "who is benefitted standard" is vague, and that owners are entitled to sufficient notice of the circumstances in which they must pay all or a higher share of certain common expenses.

2. The amendments are intended to clarify the circumstances in which assessments of common expenses to less than all of the units are appropriate. When the Study Committee considered the issue, Commissioner Cannel stated that three different interpretations of the statutory language are possible:

> (i) If the declaration . . . specifies certain common expenses that "must" be assessed against fewer than all units, then those, and only those, common expenses must be so allocated;
> (ii) If the declaration . . . specifies certain common expenses that "may" be assessed against fewer than all units, then those, and only those, common expenses may be so allocated if the Board chooses to do so, but the Board has discretion in that regard; or
> (iii) The section simply allows the declaration generally to empower the Executive Board of the Association to decide from time to time whether any common expenses shall be assessed against fewer than all units, but until such a decision is made by the Board, no such variable assessments should be made"

Study Committee Report p. 21. The proposed amendments adopt the first approach. There is a strong norm that common expenses ought to be allocated to all the units. A departure from this norm is appropriate only when the declaration specifically describes certain common expenses that are to be assessed to fewer than all units. The specification of common expenses may be by category; for example, decks, windows, or roofs. The declaration must indicate which units must pay the common expenses, but a list of units is not required if the declaration reasonably identifies the units. For example, it suffices if the declaration states: (1) "Common expenses for all skylight repairs and replacements shall be assessed to the individual unit benefitted by the skylight" or (2) "Common expenses for repairs and replacements for damage caused by flooding shall be assessed to affected units within an official flood zone."

Example 1: A community has two buildings, a ten-story tower and a long two-story townhome building. Maintenance, repair, and replacement of the roofs are common expenses. The declaration states the common expenses must be assessed in accordance with their allocated interests in the common elements, but it allows the association "to assess a common expense benefiting fewer than all of the units exclusively against the units benefitted." The Board replaces the roof on the ten-story tower. Under subsection (d), the Board must assess the common expenses for the roof replacement to all units in both buildings. The Board has no discretion to assess the common expenses only to the units in the tower. The general reference in the declaration to assessing those units that are benefitted does not satisfy the requirement in subsection (d) that the declaration specify "which common expense is to be assessed exclusively and which units are subject to the assessment." Under the existing language of Section 3-115, the Board arguably has discretion to assess the common expenses for the tower roof replacement only against the tower units.

Example 2: A community has two buildings, a ten-story tower and a long two-story townhome building. Maintenance, repair, and replacement of the roofs are common expenses. The declaration states the costs for maintenance, repair, and

replacement of a building's roof shall be assessed to the units in the building." The Board replaces the roof on the ten-story tower. Under subsection (d), the Board must assess common expenses for the roof on the ten-story tower to the units in the tower. The reference in the declaration satisfies the requirement in subsection (d) that the declaration specify "which common expense is to be assessed exclusively and which units are subject to the assessment." The Board has no discretion to assess the common expenses to the units in both buildings.

3. The proposed new subsection (h) allows the board to adopt a policy allowing unit owners to prepay assessments at a reasonable discount. One situation in which this is appropriate involves an association that has borrowed a substantial amount of money for capital improvements, to be repaid through future assessments. A policy may allow a unit owner to prepay the unit owner's share of the loan in exchange for a discount equivalent to the savings in loan interest.

Comment

1. This section contemplates that a declarant might find it advantageous, particularly in the early stages of project development, to pay all of the expenses of the common interest community himself rather than assessing each unit individually. Such a situation might arise, for example, where a declarant owns most of the units in the project and wishes to avoid ~~building~~ billing the costs of each unit separately and crediting payment to each unit. It might also arise in the case of a declarant who, although willing to assume all expenses of the common interest community, is unwilling to make payments for replacement reserves or for other expenses which he expects will ultimately be part of the association's budget. Subsection (a) grants the declarant such flexibility while at the same time providing that once an assessment is made against any unit, all units, including those owned by the declarant, must be assessed for their full portion of the common expense liability.

2. Common expenses are by their nature recurring, and the association must collect what the act calls the "periodic common expense assessment." Subsection (a) requires assessment "at least annually" and allows any shorter period. Monthly assessments are most commonly used. The association may choose to change its periodic common expense assessment if it determines a shorter or longer period is appropriate.

Reporter's Notes

1. The Study Committee Report (topic # 9) asks "What is the meaning of 'periodic assessments' in UCIOA?" and recommends: "A drafting Committee might consider the extent to which amendments might be made either to the text of the Act or the comments to clarify what was meant by the term 'periodic common expense assessment.'" The Drafting Committee at its January 2020 meeting discussed the issue. The consensus was that any period not to exceed one year is acceptable, and the comments should be revised to reflect this.

2. This addition to the comment makes it clear that the association has the discretion to select any period for assessment and payment of common expenses, provided that the period

does not exceed one year. The contrary might be inferred from two references, one in the existing text (Section 4-103(b)) and one in the comments (Section 3-123 Comment 3), both referring to “monthly” assessments. Amendments are proposed to delete both references (see Section 3-123 Comment below).