HOA MINI REPORT

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The HOA Mini Report is a quarterly newsletter providing news of legal developments of interest to homeowners associations throughout Eastern Washington. Please contact me at nick@gnbergh.com if you have any comments or suggestions, would prefer to receive this report by email, or would prefer not to receive this newsletter in the future.

I hope your holidays were joyful, relaxing, stress-free and warm. Unfortunately, the beginning of a new year snaps us back to the realities and responsibilities of everyday life. Don't forget the new Reserve Study law discussed in the last issue, Chapter 64.38 RCW took effect on January 1. Unless your association is exempt, you are required to perform a reserve study.

This issue of the Mini Report addresses association governance, first in a specific context, then in a general overview.

1. Fine!

Can a homeowners association fine members that break association rules? A trial court in Maryland recently said no.

The Maryland case involved a homeowner with a runoff problem. To control the water, she built two concrete walls in her back yard without HOA approval. Because she did not have approval, the HOA issued fines every month that she did not remove the wall. The first month the fine was $100, the second month it was $200, and every month following it was $300. The fines eventually totaled more than $2,000. She paid the fine, but sued the HOA for a refund, arguing the HOA had no authority to assess fines.

The court agreed, giving two reasons: First, the Maryland court ruled that the power to fine must be in the covenants. Because the association's covenants did not expressly give the HOA the right to impose fines, it could not do so. Moreover, the HOA bylaws authorizing fines did not help — the HOA could not create the power to fine in its bylaws, since amending the covenants to create the power to fine required more votes than amending the bylaws to try to accomplish the same thing. Second, and more troubling, the court ruled that because the power to fine is the power to punish, that power can only be exercised by governments. The second reason would seem to make any Maryland covenants authorizing fines unenforceable.

The Maryland case did not create new law, since it was issued by a lower level trial court. However, could a similar decision invalidating HOA authority to issue fines be reached under Washington law? While no Washington appellate court decision has definitively ruled on the question, the answer appears to be no.

Washington has several statutes relating to homeowners associations. One of these enumerates various powers that may be exercised by an association, and provides, in part:

> Unless otherwise provided in the governing documents, an association may. . . . after notice and an opportunity to be heard by the board of directors or by the representative designated by the board of directors and in accordance with the procedures as provided in the bylaws or rules and regulations adopted by the board of directors, levy reasonable fines in accordance with a previously established schedule adopted by the board of directors and furnished to the owners for violation of the bylaws, rules, and regulations of the association.

Unlike the case in Maryland, the Washington statute has been interpreted broadly, to allow associations to use the powers listed, even if not expressly stated in the covenants. This

result follows from the language of the statute quoted above, "Unless otherwise provided in the governing documents . . ."

One Washington court considering the power of an association to levy fines has rejected the second basis relied on by the Maryland court by ruling:

> Fines, penalties, late fees, and withdrawal of privileges to use common recreational and social facilities may be used unless prohibited by statute or the governing documents. . . . Fines and penalties are commonly used to deter violations of use restrictions. . . . The power to impose fines or penalties has been sometimes denied common-interest communities on the ground that only the government may exercise such powers, but the prevailing view regards fines and penalties as legitimate tools of the common-interest community. The amounts must be reasonable, and the procedures adopted must provide property owners with notice of their potential liabilities and a reasonable opportunity to present the facts and any defenses they may have.

Unfortunately, this decision was unpublished, meaning that it does not set precedent to guide future decisions involving the same question, and in fact cannot be cited in arguing another case. On the other hand, this decision, along with several other similar unpublished decisions, suggests that courts would likely interpret the Washington statute as authorizing HOAs to use fines to enforce covenants, even if the covenants do not specifically authorize fines.

Thanks to Walla Walla reader Dorothy O for calling the Maryland decision to my attention.

2. Differences Matter.

Homeowners associations are most commonly established as non-profit corporations, and thus are required to comply with the laws applicable to all non-profits, set forth at Chapter 24.03 RCW. However, there are additional laws (set forth at Chapter 64.38 RCW) that homeowner associations must follow, whether or not they are established as non-profit corporations. These laws are necessary because of the unique function of homeowners associations.

The most mundane of these laws address a variety of hot-button issues that have arisen over the years, among them, simplified procedures for removing discriminatory provisions from governing documents, declaring invalid provisions prohibiting the display of the US flag or political signs, installation of solar panels or the operation of adult family homes.

A more interesting example is the statute cited in the first section, which requires any fines levied by an association to comply with several specific requirements, which are derived from constitutional limitations on governmental actions:

- **Reasonable**. Any fine must be reasonable in amount. This is similar to the criminal law concept of proportionality; that the punishment should fit the crime. In the HOA context, the board should take care that the fines imposed are sufficient to encourage compliance, but not so large as to become a revenue source for the association.
- **Prior Notice**. Any fine must be in accordance with a previously established schedule adopted by the Board and furnished to the members of the association. This requirement is derived from the constitutional ban on *ex post facto* laws – governments cannot punish people for acts that were legal when done, or increase penalties over those in effect when the act was done. This provides fair warning that certain behavior will be punished, and the degree of punishment to be expected, and thus helps ensure fair treatment among various offenders.

- **Due Process**. Fines may be imposed only after notice and an opportunity to be heard, conducted in accordance with the association's established rules and regulations. This requirement is based on constitutional due process requirements. This requirement encourages fair hearings, including uniform rules of procedure, the right to offer a defense and an impartial judge.

These requirements are an implicit recognition of the fact that in some respects, a homeowner association acts as a private government, imposing rules of conduct for its members, and punishing those that do not comply, essentially using private courts developed for that purpose. These requirements are intended to ensure that the legal safeguards expected in the government courts are respected in private homeowner association judicial systems.

Another interesting example is the statute governing board meetings. Under laws related to general non-profit corporations, board meetings need not be open to all members unless required under the bylaws; in fact the statutes allow a board to take action without even holding a meeting, provided all board members agree, in writing. On the other hand, under the laws pertaining to homeowners associations, all meetings of the board must be open for observation by all members, and may close the meeting for executive sessions only on motion at an open meeting, and only for limited purposes. While notice of board meetings is not specifically required, a notice requirement must be implied, since the requirement of holding an open meeting would be easily avoided if no notice is given.

The most significant difference between the laws governing general non-profit corporations and those applicable to homeowners associations is the provision allowing awards of attorneys fees to the prevailing party in any lawsuit brought for any violation of the provisions of Chapter 64.38 RCW. There is no analogous provision in the general non-profit corporation laws. The potential financial impact of this provision is huge – under Washington law, each party pays its own attorney fees unless a contract, statute or case law provides otherwise. *Under this law, an association could be responsible for paying not only its own fees, but those of an aggrieved member for, among other things, violation of any of the prohibitions described above, defects in notice or meeting requirements, failure to establish appropriate rules and procedure for fines, or failure to comply with the reserve study requirements discussed in the last issue of this newsletter.* Knowledge and compliance with applicable requirements is essential for all association board members.

This newsletter is not a substitute for legal advice. Please consult with your legal counsel for specific advice and information.

Nick Bergh has practiced law in Washington for over 25 years, primarily handling real estate and business matters. Nick is available to provide a full range of legal services to association boards, including enforcement of covenants, collection of delinquent assessments, interpretation and amendment of governing documents, governance, and guidance regarding applicable laws. Nick works collaboratively with clients to formulate and achieve goals appropriate to each situation, and strives to be responsive and efficient in providing legal services. Nick can be reached at:

Garth Nicholas Bergh
Law Office of G N Bergh
2006 South Post Street
Spokane, WA 99203
Phone: 509-624-4295
e-mail: nick@gnbergh.com
web: www.gnbergh.com