LERCH EARLY & BREWER

# Community Associations Update

**Summer 2008**

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Welcome to another issue of the Community Associations Update, a bulletin published triannually by the Community Associations Practice Group at Lerch, Early & Brewer as a service to our clients. Here, you will find articles written by our attorneys covering a variety of current legal issues as they affect Community Association law.

As always, we welcome article suggestions and requests. If you have a suggestion, you may send it to Bill Melchior at **wgmelchior@lerchearly.com**.

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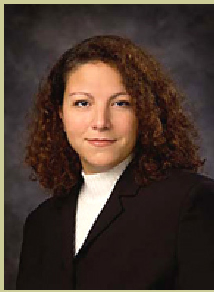
**It Is Safe To Serve: Liability of a Community Association Director and Officer**
Many people who would otherwise be willing to serve shy away because of the fear of being sued for decisions that the Board makes. Fortunately, Maryland law provides significant legal protection for directors and officers of a community association from liability when making decisions or taking action that falls within the scope of the directors' or officers' duties.

**Condo vs. HOA: Bottom Line**
Though closely related, condominiums and HOAs have distinct differences in their organization and operation. The article below will briefly and generally review and compare some of the more common



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features of a condominium and a HOA.

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## New Federal Law Requirement regarding Pools & Spas

The new **Virginia Graeme Baker Pool and Spa Safety Act** will require condominium and community associations to meet the following guidelines. As of December 19, 2008 public pools and spas must have approved anti-entrapment drain covers. Those that have only a single main drain (other than an unblockable drain) must also have at least one of the following systems: a safety vacuum release, a suction-limiting vent, gravity drainage, automatic pump shut-off or drain disablement. The measure also authorizes the Consumer Product Safety Commission to establish a grant program to distribute safety-promotion money to states. To be eligible, a state's law must require, among other things, that all outdoor residential pools and spas be enclosed by barriers that will "effectively prevent small children from gaining unsupervised and unfettered access to the pool or spa." The states law must also require that all pools and spas be equipped with devices and systems designed to prevent entrapment. Jurisdictions in the Washington-Metro Area, generally, already contain such requirements as mandated by local laws. Note, however, even if anti-entrapment drain covers are being used currently, an association may not have the proper "approved" drain covers in place and will need to swap them out to be in compliance with the new law.

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## Maryland Legislative Update, 2008 Session

**After the conclusion of one of the most active legislative sessions for common ownership community related bills in recent history, the story could be about what did not pass. In the end, however, with bills being defeated up to the last moments of the 2008 legislative session, the Maryland General Assembly passed three bills of note that impact the day-to-day operations of common ownership communities in Maryland.**

1. HB 646 – Condominium Insurance Deductible - This Bill amends Section 11 114(g)(iii)(2) & (3) of the Maryland Condominium Act to increase the amount of the deductible under the condominium master insurance policy the condominium association can pass through to the owner of the unit where the damaged originated. The previous amount of $1,000 is now increased to $5,000, if the condominium association's bylaws so provide. As a result, if a condominium's bylaws so permit, when damage is caused by a casualty, fire, burst pipe, etc., the condominium can now hold the unit owner responsible for the cost of the deductible under the condominium master insurance policy, up to $5,000.00, and the remaining amount, if any, is a common expense. This new law becomes effective on October 1, 2008.

2. HB 645 – Time To Foreclose on a Lien – This Bill amends the Maryland Contract Lien Act to extend the period of time that a community association can foreclose on its liens for unpaid assessments from 3 years to 12 years. This Bill was prompted by recent practice of some settlement companies refusing to pay off liens that were older than 3 years, because the lien could no longer be foreclosed upon. This new law becomes effective on October 1, 2008 and will then apply to existing liens.

3. HB 117 – Restrictions on Solar Collection Systems – This Bill addresses the ability of a common ownership community to restrict the placement of solar collection systems and

matters including corporate, tax, property, bankruptcy and financing issue

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creates a solar easement as a valid type of easement in Maryland. Under the new law, a common ownership community may not impose or act to impose any unreasonably limitation on the installation of a solar panel on the roof or exterior walls of a home or a building, if the owner owns the roof or exterior wall or if the owner has exclusive use over that portion of the structure. In other words, a Board of Directors of a homeowners association cannot prohibit the installation of a solar panel on the roof of a house, and condominiums cannot prohibit the installation of a solar panel on a limited common element balcony appurtenant to a unit. We believe the limited common element application of this bill is practically unworkable, as most solar panels require larger coverage area to function properly. The condominium can prohibit the installation of solar panels on the building's roof or other general common element locations.

This Bill also recognizes the creation of a solar easement in Maryland. Essentially, a solar easement is a written agreement entered into by two neighbors, where one neighbor agrees to not take any action, e.g., planting trees that would block the sun to the other neighbor's solar panels. The granting of this type of easement is totally voluntary and is to be negotiated between the two neighbors, but is recorded in the County Land Records, and will run with the land, binding all successors in interest, unless otherwise provided for in the easement. This new law becomes effective on October 1, 2008.

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## Maryland's Highest Court Rules on Applicability of Insurance Provisions Under the Maryland Condominium Act

**Arguably, one of the most important cases ever involving the Maryland Condominium Act and master policy insurance has been decided by Maryland's highest court. Anderson, *et al.* v Council of Unit Owners of the Gables on Tuckerman Condominium, *et al.* - Case No. 99, Sept. Term 2007 - was decided on April 15, 2008 by the Maryland Court of Appeals.**

On April 15, 2008, the Maryland Court of Appeals issued its decision in Diane Anderson, et al. v. Council of Unit Owners of The Gables on Tuckerman Condominium, et al. (No. 99, Sept. Term, 2007). In reviewing the issues, the Court determined that Section 11-114 of the Maryland Condominium Act was in conflict with Section 11-108.1. Section 11-108.1 of the Act specifically addresses a unit owner's obligation to maintain, repair and replace his "unit" and addresses the Association's obligation to maintain, repair, and replace common elements of the condominium. Upon finding there was an ambiguity under the Act in relation to whether the association or the Unit Owner had the obligation to repair or replacement a unit after a casualty, the Court determined that a condominium association is not required to maintain master insurance policy property liability coverage on the units within the condominium. Instead, the Court opined that Section 11-114 of the Condominium Act merely requires a condominium association to carry a master insurance policy to cover the common elements and the structure of the condominium, and further held that the condominium association is not required to insure and carry coverage for the individual units. Note, however, while the Court's opinion established that the Act does not require a condominium association to cover the Units, it does not preclude an association from doing so.

The opinion of the Court in *Anderson*, is a major deviation from how the Act has been interpreted since its inception. Prior to the Court's ruling, the Act was interpreted to require condominiums to carry a master insurance policy that would provide primary coverage for casualty losses to the common areas, the structure, and the individual units, excluded

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improvements and betterments in the units. As such, condominium associations assumed primary responsibility for making repairs in the event of a casualty loss and the master insurance policies covered such claims.

The state of law that now exists provides that a condominium association is not required, under the Maryland Condominium Act, to carry master insurance policy casualty loss coverage on the units. A condominium association is only required to carry a master insurance policy to cover the common elements and the structure of a condominium. Notwithstanding the Court's opinion, a condominium is still required to carry whatever insurance coverage is required by its governing documents. It is important for the Board of Directors to verify the requirements as stated in the bylaws of the Association to determine what insurance coverage is required to be carried by the Association. In addition, it should be noted that the opinion does not act to modify the coverage of any insurance policies now in place, as those policies (as a contract) require the insurance carrier to provide the coverage specified under its terms. In all likelihood, this issue will arise at the time of renewal.

It should also be noted that Section 11-114 of the Maryland Condominium Act was modified by the legislature this year (2008 Legislative Session), which change becomes effective October 1, 2008. Specifically, the Maryland Legislature passed an amendment to the existing provisions of Section 11-114 that now allow a condominium to pass along the master insurance policy casualty loss deductible, up to a maximum of $5000, to a Unit owner where the cause of the damage originated. This amendment to the Act increases the maximum amount that could be passed along from the previous $1000 maximum to a $5000 maximum, for losses occurring after October 1, 2008.

In addition to the issues above, the Board should be aware that many individual Unit owner insurance providers are sending notices to their insureds (the Unit owners), regarding the *Anderson* opinion. The individual Unit owner insurance policy providers (these policies are referred to as "HO6" policies), are asking their unit owners to contact the condominium to find out whether there will be any modification to its master insurance policy as a result of the *Anderson* opinion. The HO6 carriers are trying to determine whether or not it will be necessary for their policyholders (the individual unit owners), to increase their casualty loss coverage to increase coverage to cover the Unit itself (or at least increase coverage), which was previously covered by the master insurance policy in place. Most HO6 policies, as written under the interpretation of the requirements of the Act prior to *Anderson*, do not carry enough coverage to insure (in sufficient amounts) the Unit in case of a casualty loss, as those policies relied on the primary coverage carried by the condominium association as part of its master insurance policy. As such, the Board may receive inquiries from Unit Owners regarding its coverage.

The above case is cited **here**.

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## It Is Safe To Serve: Liability of a Community Association Director and Officer

**Serving on the Board of Directors of your association can be a rewarding experience, depending on whom you ask. Many people who would otherwise be willing to serve shy away because of the fear of being sued for decisions that the Board makes. Fortunately, Maryland law provides significant legal protection for directors and officers of a community association from liability when making decisions or taking action that falls within the scope of the directors' or officers' duties.**

### Immunity:

Under §14-118 of the Maryland Real Property Article and §5-422 of the Maryland Courts and Judicial Procedures Article, directors and officers of a community association cannot be held liable for injuries to a third-party if the director or officer:

1) acted within the scope of the director's or officer's duties;
2) acted in good faith; and
3) did not act in a reckless, wanton or grossly negligent manner.

This standard affords directors of community associations greater protection than that afforded directors of corporations generally. The Maryland Code provides that a director of a corporation is generally immune from liability for his or her actions if the director acted:_

1) in good faith;
2) in a manner he or she reasonably believes to be in the best interests of the corporation; and
3) with the care that an ordinarily prudent person in a like position would use under similar circumstances.

**Naming A Director Or Office In A Lawsuit:**

Individual Board members or officers of a community association, in such capacity, cannot be named as defendants in a complaint for injuries. In other words, if a member of the association sues the association over a decision of the Board, that member may not name individual directors, personally, in such lawsuit. Only the community association, as an entity, may be named in the Complaint. Specifically, MD Code, Courts and Judicial Procedures, §5-422(d)(1) provides:

> (d)(1) Except as provided in paragraph (2) of this subsection, a claimant shall name only the governing body as a party defendant.
> (2) An officer or director of a governing body may be named individually only when the governing body for which the officer or director was acting cannot be determined at the time an action is instituted under this section.
> (3) If an officer or director is named as an individual defendant under this section, the governing body for which the officer or director was acting shall be substituted as the party defendant when its identity reasonably can be determined.

In practice, however, officers and directors are routinely named in lawsuits notwithstanding the above, but will generally be dismissed from the case under section (d)(3) above.

**Limitation of Recovery:**

Even if someone were to sue the association for tortious actions of a director (e.g. negligence or defamation), Maryland law limits the amount of damages that a person can recover. Specifically, MD Code, Real Property, §14-118(b) provides that a person who sustains damage from the tortious act of an officer or director, while the director or officer is acting within the scope of his or her duty, may only recover in an action brought against the governing body for actual damages. This limitation on recovery applies only to tort actions and not contract claims.

**Insurance Implications:**

Additional levels of protection are provided to directors and officers through the association's directors and officers liability insurance policy ("D & O Policy"). If the association maintains a D & O Policy and the Board or officers are named as defendants in a lawsuit in which monetary

damages are sought, the D & O Policy, in most circumstances, will cover the cost of the defense, the attorneys' fees, and the officer or director will not be personally liable for damages. Interestingly, if the complaint fails to request the award of monetary damages, most D & O Policies will not cover the cost of the defense.

Maryland law further provides that when the damages are covered by insurance, the plaintiff may recover damages from the Association only to the extent of the applicable limit of insurance coverage, including any amount for which the association is responsible as a result of any deductible or coinsurance provisions of such insurance coverage. MD Code, Courts and Judicial Proceedings §5-406(c).

In short, if you act in good faith to comply with the governing documents of the association in making decisions, act in a conscientious manner while performing your duties, and due not steal or misappropriate funds, your risk of personal liability for serving as director is minimal.

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## Condo vs. HOA: The Bottom Line

**A Community Association is a category of entities known as common ownership communities, including condominiums, homeowners associations ("HOAs"), and housing cooperatives. Of the three, condominiums and HOAs are the most common and closely related. A cooperative is a significantly different type of creature, and is best left to a later discussion. Though closely related, condominiums and HOAs have distinct differences in their organization and operation. The following will briefly and generally review and compare some of the more common features of a condominium and a HOA.**

### Condominium

A condominium is generally defined as a type of joint ownership of real property in which portions of the property are commonly owned (the common elements), and other portions are individually owned (the units). A condominium is created upon the recordation of a declaration, bylaws, and a condominium plat in the local county or municipal land records.

Comprising the condominium regime are unit owners, collectively known as the "council of unit owners". This council of unit owners is empowered to run the condominium, but most of the powers and duties are delegated to a board of directors, except for those enumerated powers reserved for the council of unit owners. The council of unit owners elects the Board of Directors.

Each unit owner owns their unit, traditionally an apartment style residence, and undivided interest in the common elements, in accordance with the unit owners' percentage interest, which is set forth in the Declaration. Each unit has a separate parcel identification or tax ID number, but because the common elements are collectively owned, there is no separate parcel ID or tax ID for common elements.

The boundaries of a unit are found within the condominium's Declaration and plats, and sometimes in state statutes. Generally, the boundaries of the unit include the exterior surface of the unit's drywall inward and from the interior surface of the concrete floor slab upward, but may vary from condominium to condominium. Contained within the units are all of the appliances only serving that unit, all plumbing located solely within the boundaries of the unit, and carpeting.

The common elements are broken down to general common elements, and limited common elements. General common elements are available for use by every unit owner. General common elements often include the roofs, sidewalks, elevators, common hallways, lobby and

community facilities. Limited common elements are portions of the condominium designated or assigned for the exclusive use of one or more, but less than all, of the unit owners. The designation of limited common elements is often found in the condominium's Declaration or on the plats, and in some cases, the designation is within the discretion of the Board of Directors, as in the case of parking spaces. Common examples of limited common elements are balconies and patios serving a unit.

The maintenance, repair, and replacement responsibility is what really distinguishes a condominium. Generally speaking, the condominium is responsible for the maintenance, repair, and replacement of all of the general common elements, and the repair and replacement of the limited common elements. The unit owner is frequently responsible for the maintenance, repair, and replacement of the unit, and the maintenance of the limited common elements designated for that unit owner's exclusive use.

Funding the operation of the condominium are assessments. Subject to some restrictions, the Board of Directors is responsible for annually determining the common expenses of the condominium. Each unit owner will be assessed that unit owner's share of the common expenses based on the unit owner's percentage of ownership interest. The general rule is, the larger the condominium unit, the greater the proportional share of the common expense owed.

**Homeowners Association**

A HOA is defined as an entity, comprised of homeowners residing within a particular area, whose principal purpose is to ensure the provision and maintenance of community facilities and enforcement of the various covenants and restrictions. A HOA is created upon the recordation of a Declaration of Covenants, Conditions and Restrictions (''DCC&R'') in local land records. Each lot and common area is subject to the DCC&R. Unlike a condominium, the bylaws of the HOA are not recorded in land records.

A HOA is comprised of the owners of the lots that serve as the HOA's members. The HOA's Bylaws will delegate the obligations for governing the affairs of the HOA to a Board of Directors. The Board of Directors is generally charged with determining the amount of annual assessments, adopting rules and regulations and architectural guidelines, maintaining the common area, and enforcing the various governing documents of the HOA.

Each member of the HOA owns their individual lot purchased via a deed. The boundaries of the lot will be as defined in the legal description contained in the deed. The HOA, not the lot owners, own the common area through a common area deed, normally from the declarant. The owners have no ownership interest in the common areas. The owners are granted a right to utilize and enjoy the common areas through a grant of easement contained in the DCC&R. The owners' easement to use and enjoy the common areas is subject to the covenants and restrictions contained in the DCC&R and the rules and regulations adopted by the Board of Directors. Often the right to utilize the common areas can be suspended for violations to the HOA's rules and regulations or for failure to pay assessments.

The HOA is responsible for maintaining, repairing and replacing the common areas. The common areas may include the parking lots, sidewalks, green space not included within the lots, tot lots, swimming pool and other recreation facilities. The owners will be responsible for maintaining, repairing, and replacing their lots, including the landscaping within their property boundaries and the exterior of the owner's home. There are some HOAs where the DCC&R permits the HOA to assume the responsibility of the landscaping of lots. Any exterior additions, alterations or improvements on a lot undertaken by an owner will need to be pre-approved by the HOA's Board of Directors or its designated committee.

Due to the reduced maintenance, repair, replacement and insurance obligations, an HOA's assessments are often considerably less than a comparably sized condominium. Hereto, the Board of Directors is responsible for determining on an annual basis what funds will be required to meet the anticipated expenses of the HOA for the then upcoming fiscal year. By virtue of ownership of their lot, each owner is required to pay for that owner's share of the common expense assessed against the lot. An owner's obligation is based on the total amount of the common expense divided by the number of lots within the association. This calculation may vary if there are different types of homes comprising the HOA, such as townhomes and single-family homes within the same HOA.

**Conclusion**

Living within a community association has significant benefits. Understanding the basics of each type of community association will allow prospective owners to know what to expect and allow existing owners to know how to get the most out of their community association's ownership experience.

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## We Would Like To Hear From You

We publish this newsletter as a service to our clients as a means to make them aware of certain aspects of the law. As always, we would like to hear feedback from our readers regarding the content of the newsletter. If there are items or topics you would like to see covered in future issues, or you have a suggestion concerning the newsletter itself, you may send them to Bill Melchior at **wgmelchior@lerchearly.com**, or via phone at 301-961-6096.

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