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Transition: Master Deed and By-Law Provisions that Every Condominium Association Trustee Should Know

By Eric F. Frizzell, Esq., Buckalew Frizzell and Crevina, Glen Rock, New Jersey

The transition of control of a condominium association's board of trustees from the Sponsor to the unit owners marks the beginning of a critical period in the life of an association. Although an association's property manager, attorney, engineer and accountant will guide a board during much of transition, it remains incumbent upon each trustee to be familiar with the association's two key governing documents, the master deed and by-laws. A board's thorough knowledge of these documents can be instrumental in better managing an association, avoiding legal problems, and assisting in a smoother transition. This article highlights some of the significant provisions that are commonly found in a master deed and by-laws.

Insurance. The governing documents normally detail the specific forms of insurance coverage that an association must possess. A board should obtain written confirmation from the association's insurance agent that all such insurance has been obtained, and that adequate Directors and Officers liability insurance is in place to protect individual trustees against personal liability for claims relating to their service on the Board.

Reserve Funding. The governing documents may expressly obligate a board to fund specific types of reserve accounts. A board's failure to adequately fund reserve accounts for future, deferred maintenance and capital replacement projects, especially when expressly required by the governing documents, may constitute a breach of the board's fiduciary duty that may result in a lawsuit against the association and individual board members.

Fines and Late Fees. A board may not impose fines or late fees on unit owners unless the governing documents expressly authorize such action. Even if a board is authorized to impose fines and late fees, the governing documents may limit their amount, mandate particular notice before imposing them, or contain similar constraints.

Protection of "Eligible Mortgage Holders" and other Lenders. The governing documents may prohibit an association from taking certain actions (e.g., becoming self-managed) without obtaining the prior written approval of a specified percentage of "eligible mortgage holders" or other lenders. This prohibition is intended to protect holders, insurers or guarantors of first mortgages on units, who have requested the association to notify them and seek their prior approval of proposed material changes in the administration of the association that might adversely affect their security interests. Most mortgage lenders do not exercise these rights, but a board nonetheless should confirm with its property manager whether there are any eligible mortgage holders and, if so, apprise the association's attorney.

The governing documents may contain an even more onerous provision that requires an association to obtain the prior written approval of *each* institutional holder of a first mortgage lien on any unit in the condominium before any material amendment to the master deed or by-laws can be made. Whether such provisions would actually be enforceable raises legal issues that are beyond the scope of this article.

Casualty Loss. In the event of a fire or other casualty loss, the governing documents may impose detailed obligations on an association regarding the handling of insurance proceeds and the repair or reconstruction of damaged or destroyed units. Failing to comply with these provisions can result in protracted litigation by affected unit owners against the association and individual board members.

Indemnification. Sometimes trustees get sued individually. As stated above, a board should assure that the association possesses adequate Directors and Officers liability insurance to protect against such claims. But "D&O" insurance does not cover every type of claim. Accordingly, trustees should confirm that the by-laws indemnify them to the full extent permitted by the New Jersey Nonprofit Corporation Act. Although the Act requires nonprofit corporations such as condominium associations to indemnify trustees in particular situations, the Act permits a corporation to further indemnify its trustees against liability in an action instituted by the corporation itself or in a shareholder's derivative action, but only if this greater protection is expressly set forth in the by-laws or certificate of incorporation.

Of course, an association cannot provide unlimited indemnification -- New Jersey law prohibits a trustee from being indemnified at all against liability in a suit brought by or in the name of the association if a judgment or other final adjudication establishes that the trustee's acts or omissions (1) were in breach of the trustee's duty of loyalty to the corporation or its members, (2) were not in good faith or involved a knowing violation of law, or (3) resulted in receipt by the trustee of an improper personal benefit.

Leasing Restrictions. Sometimes a board wants to restrict the leasing of units. Under the Condominium Act, however, all restrictions or limitations upon the leasing (or use, occupancy, transfer, or other disposition) of any unit must be set forth in the master deed or its exhibits (e.g., the by-laws).

In addition, a board should note whether the governing documents require all leases between investor unit owners and their tenants to include a "rent assignment" provision or rider. A rent assignment provision is an invaluable collection tool against investor-unit owners who are delinquent in their payment of common expenses because it authorizes an association to collect from the tenants all rent that they would otherwise pay to their delinquent landlord-unit owners.

Sometimes a board wants to charge fees to unit owners who rent their units. If authorized by the governing documents, a board can charge a "reasonable rental review fee," i.e., the fee must be reasonably related to the association's actual cost of reviewing the rental transaction (the lease) and inspecting the unit to assure there has been no damage to it. If the association cannot demonstrate that the fee is reasonably related to these two purposes, the fee could very well be invalidated if challenged in court, on the grounds that it is nothing more than a revenue raising

device that imposes a disproportionate amount of common expenses on investor-owners who rent their units. In fact, under four court decisions in New Jersey since 1996, a board would be well advised to not impose any fee on unit owners, unless expressly permitted to do so by the Master Deed, By-Laws or Certificate of Incorporation.

Alternative Dispute Resolution. New Jersey law requires a condominium association to provide an alternative to litigation for resolving housing related disputes between the association and unit owners, or among unit owners themselves. If the governing documents include ADR provisions, a board must comply with them. Even if such procedures are absent from the governing documents, the board still must provide an acceptable form of ADR. The establishment of ADR procedures is important for numerous reasons, including because under the Condominium Act, an association may not impose any fines on a unit owner unless the owner is given written notice of the action taken, its alleged basis, and the right to participate in ADR.

Open Meetings. New Jersey law also requires that all board of trustees meetings, except conferences or working sessions at which no binding votes are to be taken, must be open to attendance by all unit owners, subject to certain exceptions. In specific, the Board may exclude or restrict attendance at those portions of meetings at which any of the following matters would be discussed: (1) any matter the disclosure of which would constitute an unwarranted invasion of individual privacy; (2) any pending or anticipated litigation or contract negotiation; (3) any matters falling within the attorney/client privilege, to the extent that confidentiality is required in order for the attorney to exercise his ethical duties as a lawyer; (4) any matter involving the employment, promotion, discipline or dismissal of a specific officer or employee of the Association. Moreover, the Association is required to provide adequate written notice of the time, place, and agenda, to the extent known, of all open meetings, at least 48 hours in advance. These requirements should be included in an association's by-laws, but will apply even if they are omitted.

Division of Responsibility for Maintenance and Repairs. The master deed and by-laws delineate responsibility between the association and individual unit owners for maintenance, repairs and replacements to the units, and the general and limited common elements. A board should be very familiar with these provisions, as they are often the subject of dispute.

Moreover, in the event of a casualty loss such as fire or storm damage, the normal division of responsibility for repairs and replacement may shift, with an association being responsible for repairs and replacements of original flooring, cabinetry, appliances and other "unit betterments", for which unit owners are normally responsible in a non-casualty loss situation.

Acceleration and Other Collection Procedures. The by-laws frequently require an association to follow specific procedures with regard to filing lien claims or instituting other collection action against delinquent unit owners. An association's failure to comply with these requirements could result in the collection action being invalidated by a court.

A board also should determine whether the by-laws allow it to “accelerate” the monthly maintenance of delinquent unit owners. Normally unit owners are permitted to pay their annual assessment in twelve equal monthly installments. Acceleration allows a board to demand that a delinquent owner immediately pay all remaining common expense installments that are due through the end of the fiscal year. Acceleration is an extremely beneficial collection tool, especially against chronically delinquent unit owners, because it enables an association to sue a unit owner in a single lawsuit for all common expenses that will become due through the end of the association’s fiscal year, as well as for the following fiscal year if the lawsuit is still pending when the new year begins.

Attorney-in-Fact. Sometimes associations experience difficulties with tenants of investor-unit owners who are disturbing the quality of life of other residents or otherwise violating the association’s governing documents. An attorney-in-fact provision states, in essence, that if a tenant is committing such violations, and the investor-unit owner fails to attempt to evict the tenant after demand by the association, the association has the right to prosecute the eviction action and to charge the investor-unit owner with all of the resulting legal fees and court costs.

Immunity. Under a New Jersey statute, where an association’s by-laws so provide, an association “shall not be liable in any civil action brought by or on behalf of a unit owner to respond in damages as a result of bodily injury to the unit owner occurring on the premises” of the association, unless the association caused the injury by its wilful, wanton, or grossly negligent act of commission or omission. In essence, the statute allows an association to immunize itself against a negligence action by a unit owner who seeks damages for a bodily injury suffered on the premises of the condominium. To obtain this immunity, however, the by-laws must expressly provide it.

Satellite Dishes. Many governing documents contain provisions that purport to prohibit unit owners from erecting satellite antennas. During the last few years, however, the Federal Communications Commission issued new rules regarding satellite dishes, and severely limited the restrictions that associations can impose on unit owners who want to install them. Accordingly, even if the governing documents restrict or prohibit satellite antennas, the board should consult the association’s attorney if installation of antennas becomes an issue.

Quality of Life Restrictions. The master deed usually contains numerous restrictions on the use of common elements and units by unit owners. These restrictions are supplemented by the association’s rules and regulations. The board should be well- versed with the restrictions and rules and regulations, to assure that they are fairly enforced and to maintain the quality of life in the community.

Conclusion. By becoming familiar with these and other provisions in the master deed and by-laws, every trustee can contribute significantly towards the success of the overall transition process.