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NO RIGHT TO REFUSE PAYMENT

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THE COURT TURNS A RIGHT INTO A DUTY AS IT ORDERS A BOARD TO ASSESS ITS MEMBERS TO PAY A CREDITOR

A 2005 decision of the California First Appellate District Court of Appeal in *James F. O'Toole Company vs. Los Angeles Kingsbury Court* answers the question: can association members be forced to pay, by special assessment, debts incurred by their association? Essentially, *O'Toole* upholds a lower court order requiring a community association to levy a special assessment to pay a judgment creditor. The importance of *O'Toole* is that a community association was required to pay its debts—every person or entity should pay what it owes. The importance of *O'Toole* is that the court required the board of directors to levy a special assessment upon the members, one that the members had specifically rejected, to pay the obligation. The court also appointed a receiver¹ to enforce collection of the assessment, and pay the creditor.

The appellate court cited Section 1366 (a) of the California Civil Code, which states:

"Except as otherwise provided in this section, the association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title."

The court held that Section 1366(a) mandates that common interest developments in California levy assessments sufficient to perform their obligations. But the court went further and stated that the association's maintenance and repair obligations also created a duty to assess its members. The trial court stated:

"... the Association's general duty to maintain its property contained a more specific duty to meet its legal obligations ... and that it was thus required to levy a special assessment to (raise the necessary funds.)"

In this case the "legal obligation" was a creditor's judgment. But could it not have just as easily been the repair of a roof? The court spent a lot of time discussing "emergency" assessments because the association claimed it did not have the authority to levy the assessment. The court found that the emergency exception set forth in Civil Code

Section 1366(b) (1), an assessment to comply with an order of the court was applicable here. But what about CC 1366(b) (2), an emergency expense necessary to repair or maintain something that poses a threat to "personal safety?" Or, CC 1366 (b) (3), an expense that the board could not have reasonably foreseen when the present budget was prepared? It could be argued that either of these exceptions would empower a board to impose an assessment without a vote of the members where a serious maintenance or repair obligation existed.

The interesting part of this decision, however, is not its discussion of the exceptions to member approval. The real interesting part of this decision is that it holds that the association not only has a right to impose assessments to meet its legal obligations, but that it has a duty to do so. Further, this case reminds us that if a board fails in its

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"duty," the court can essentially fire the board and install its own representative, in this case a receiver, to do the job.

The statutory language compelling the board to levy adequate assessments has always been in the Davis-Stirling Act, and so have exceptions to the requirement that members must approve assessments above a certain amount. This decision says that a court can enforce these provisions by ordering the association to assess its members and then appointing a receiver to carry out that order. This has implications for all community associations that lack the necessary cash to complete necessary repairs, but whose members might have refused to approve a special assessment. Again, *O Toole* was based on an association's failure to pay a contractor for his services. But the holding of the court relies on statutory law that is not limited in scope to just the debts of creditors.

So, how bad does the siding have to get before a board is legally required to assess its members for its replacement without the necessity of seeking their approval? Certainly, a board would be justified in imposing a special assessment if the siding or roofing or decks gets bad enough to pose a threat to personal safety. But CC 1366 (b) (3) only requires that the board show that it was unaware of the problem at the time it formulated the last budget. So, if a catastrophic collapse of a balcony occurs after the last budget that is found to be a precursor of other such failures, and the board didn't know about it earlier, it could be argued that it has the right to assess for the repair of such failures without a member vote. Taking this analogy further, and applying the ruling in *OToole*, this right can become a duty to assess the members for those repairs, a duty that could be enforced by a court.

It might be said that Civil Code Section 1366 has always provided that the association's board of directors has a duty to levy assessments for major repairs. But *OToole* is a clear statement that, in the proper case, the board not only has the duty but also that a court can and will enforce that duty with an order and, if necessary, appoint its own representative to enforce that order.

This case is not so surprising when one considers that ownership of an interest in a common interest development is a little like owning stock in a corporation. You would want the managers of that corporation to take whatever steps are necessary to preserve the corporation's assets. In a community association the assets are its buildings. Those community associations that have deferred essential maintenance to the point that the condition of the buildings might be a threat to personal safety or where a board has just discovered that the buildings require major repairs that were unexpected and unfunded should consider whether the circumstances are such that *OToole* might apply. If so, they might not want to wait until someone decides to bring the matter to the attention of a court.

But what happens when the members do not have the means to pay the amounts ordered by the court? In the *OToole* case, it was a contractor who was owed a fee for performing services for the association—a fee that the association refused to pay. The court not only ordered the association to assess its members; it appointed a receiver to insure that the court's order was followed. We speculated that if the case stood for the proposition that the court could order the association to assess the owners to pay this obligation, what about other obligations of the association?

What if, for example, an owner, tired of waiting for an association to repair the roof, sued the association to force it to make the repairs and prevailed, obtaining a judgment of the court that the association must repair the roof. Would *O Toole* be used as authority to require the association to assess its members for the funds necessary to make the repair? We see no logical distinction to be made between the obligation to pay a creditor and the association's obligation to make repairs. Therefore, in the proper case, we believe *OToole* could, and perhaps will, be cited in support of just such a claim by an owner or group of owners who are dissatisfied with the association's performance. The only defenses that would likely be available to an association would be: whether the

association is responsible for the repairs;

whether the repairs are necessary; and the scope of such repairs. And, if the association were to lose, *OToole* says the court could enforce its judgment by ordering the board to impose an assessment on the members.

The foregoing is not a far-fetched scenario given the declining physical condition of many community associations today. Many boards are reluctant to raise assessments, and owners are reluctant to pay them, which means that a lot of required maintenance is being deferred—often for many years. But if *OToole* is not overturned on further appeal, and remains the law of the State of California, it is likely that we will see, within the next few years, a case of a court requiring a community association to perform repairs and further ordering the members to be assessed to pay for them.

Let's assume that happens. But let's also assume that, as is frequently the case, the cost of the necessary repairs exceed the cash reserves of the association, requiring a special assessment. So, the court orders the association to assess the members. But nobody can pay! Now what? The assessment, per unit, is so high, that no owner has the resources to cover it. Since the association has not complied with the court's order by repairing the roof, the court orders the appointment of a receiver. But what can the receiver do? In *OToole*, the court did not find that the owners were personally liable for the obligations of the association, only that the association had the right, and the duty, to levy a special assessment. *OToole* gave the association no special fund raising power beyond that typically found in most management documents. In fact, the court went to some length to state that it was not creating a personal obligation of the owner beyond what is found in the CC&Rs. So the receiver, standing in the shoes of the association, can only initiate collection procedures as provided by the governing documents and state law.

The receiver, at most, could collect the assessment using the lien powers of the association, which, in California, usually means nonjudicial foreclosure. Taking this example to its inevitable

extreme, the non-paying owners have their property sold or re-possessed by their lenders. This, of course, is the same scenario that could occur if mandatory full funding of reserves was legislated such that associations with large unfunded repair liabilities could not meet the legislative dictate. And how has this solved any problems? Does it get the roof fixed? Probably not, because while the collection efforts of the receiver would garner a portion of the funds, the foreclosing lenders, because of their superior lien rights, will probably avoid the collection lien altogether. Of course, in order to re-sell the property, the issue of the deferred repairs would have to be disclosed, and the value of the foreclosed property may fall.

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The basic lesson taught by *O'Toole* is that the courts are not willing to treat community associations as a special case and will require them to meet their obligations just like any other legal entity. And, as a practical matter, the owners cannot be shielded by the association's corporate status. The O'Toole court did recognize the status of owners in a community association as being like that of corporate shareholders-meaning that the corporation's debts were not the personal debts of the owners. But that is a distinction without a difference where the courts are willing to force the association to exercise its lien powers against the owner's property to collect the debt, as occurred in *O'Toole*.

And it also forces a reality check. Unless the owners are willing and able to contribute the necessary capital, a community association badly in need of repairs really can no longer function as one, especially once the courts or a municipality intervene. What we have in *O'Toole* is nothing short of a court assuming control of an association when the association is unable to perform its obligations. For many years we have wondered what would happen if an association could not raise the funds to meet its responsibilities. Now we know.

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