KMK KASS, MITEK & KASS, PLLC

Newsletter

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THE BUSINESS JUDGMENT RULE

By: Benny L. Kass, Esq.

What exactly is the "business judgment rule"?

To my knowledge, this "rule" began in Delaware many years ago, created by judges to protect members of a Board of Directors from liability for decisions they make. In effect, a judge will say "even if the board (or a director) made a mistake, we will not second guess or punish them unless they have done something criminal or truly nefarious".

Many states including Maryland, Virginia – and more recently the District of Columbia – have adopted the business judgment rule for condominium associations.

Why? Because service on a condo association board is a thankless, payless position, and if board members can also be sued and be personally liable for money damages because a homeowner is upset, those board members will not serve. Many board members have told me that but for the business judgment rule – as well as the Officers and Directors insurance – they would never have agreed to be on the board.

The courts have consistently held that volunteer board members are not perfect, and will make decisions that are not always correct.

(Continued on page 2)

SHOULD YOUR CONDOMINIUM ASSOCIATION INCORPORATE?

By: Mark M. Mitek, Esq.

Perhaps the primary reason to consider incorporating is that a corporation may usually act as a shield to protect the individual officers and directors from personal liability if the corporation is sued. An officer or director of an association must take his or her job seriously. Becoming a member of a Board of Directors is not an easy task; indeed, it is fraught with problems, complaints and criticisms. As those who serve (or have served) well know, the hours are long and the pay is short -- i.e., zero. Furthermore, when one assumes the position of an officer or director, there can be personal liability if the Association is sued. Officers and directors may be brought into such a lawsuit merely as a "scare" tactic to help reach a quick settlement. This does not, of course, mean that

(*Continued on page 3*)

In this issue...

(Continued from page 1)

The Business Judgment Rule

A recent case from New Jersey defined the rule as follows: "the test is (1) whether the association's actions were authorized by statute or by its own bylaws... and if so (2) whether the action is fraudulent, self-dealing or unconscionable." If a contested act of the association meets each of these tests, the judiciary will not interfere.(Anklowitz v. Greenbriar at Whittingham Community Association, decided August 29, 2014.

One author, writing in the Valparaiso University Law Review, pointed out that "the rule is multi-faceted. Most generally, the business judgment rule acts as a presumption in favor of corporate managers' actions. Stronger still, the rule provides a safe harbor that makes both directors and their actions unassailable if certain prerequisites have been met."

In the District of Columbia, for many years the business judgment rule for condominiums was rejected by the courts; instead, the courts imposed a "reasonableness" test: was the board reasonable in taking (or not taking) the action complained of? While this often generated more favorable decisions in favor of condo owners, it created uncertainty and anxiety among board members – as well as additional time and legal expenses while the court decided each case.

However, the DC City Council recently amended the condominium act. Among many other provisions, the reasonableness test was rejected in favor of the business judgment rule. According to the committee report, that rule "is generally thought to be more deferential to the informed judgment of the association or executive board, giving such bodies confidence to govern without fear of second guessing by courts."

However, the report warned "that it does not absolve officers from their fiduciary duties. They must still work in good faith, stay reasonably informed, and only take actions in furtherance of the legitimate interests of the condominium association they represent... Under the business judgment rule, officers would still be liable for instances of fraud or negligence and actions can be overturned where they fail to adhere to the association's instruments and procedures."

This, in my view, is a good summary of the rule. In effect, it still preserves the element of "reasonableness".

However, I have one disagreement with that statement, namely, board members should be more than "reasonably informed". They should be fully informed. I cannot tell you how many board members have openly admitted they never bothered to read their association's legal documents; is that good "business judgment".

(Continued from page 1)

Should Your Condominium Association Incorporate?

the officer or director will ultimately be held liable, but the inconvenience (and the cost) of defending the litigation is often quite burdensome.

Although there are defenses to the litigation, the officers and directors will have to retain separate legal counsel to raise these defenses in the court suit. Generally, in the District, directors and officers cannot be held personally liable if they exercise good business judgment. However, the DC Condominium Act states that directors and officers shall exercise the care required of a fiduciary for unit owners. That "fiduciary" standard is the highest duty known in the law, usually associated with a trustee or personal representative. Such a duty may result in liability against officers and directors, even in cases in which there were no intentional wrongdoing and where they did not personally profit from their actions.

In 1992, the City Council (the legislative arm of the District) enacted a law, which has been amended from time to time, granting limited immunity to volunteers, including officers and directors, of non-profit corporations who do not receive compensation, except for reimbursement of expenses. This immunity is limited as follows:

1. The officer or director remains fully liable for willful misconduct, criminal activities, personal gain at the expense of the association, or an act or omission that is not in good faith and beyond the scope of authority of the corporation.

2. The immunity only applies if the corporation maintains liability insurance with a limit of coverage of not less than $200,000 per individual claim and $500,000 per total claims that arise from the same occurrence. (See Section 29-406.90, D.C. Code). There is a similar law limiting the liability of employees of corporations. (See Section 29-406.91).

What does all this mean? First, anyone who serves as an officer and director of a community association must learn the duties and responsibilities of that office.

Second, if you are an officer or a director make sure that your association maintains adequate officers' and directors' liability insurance. Obtain a copy of the policy and confirm that it is current. You should ensure that all fidelity bonds in connection with bank accounts, etc., as required by your documents are actually in place. As a board member and/or officer, you may even wish to consider having other applicable forms of insurance, which you may be able to supplement your unit owner's insurance policy -- a relatively inexpensive way of providing yourself with additional protection when serving on Board.

Third, under the DC Condominium Act, condominium associations may be either incorporated or unincorporated. If your association is not incorporated, you should explore changing its status.

What are the pros and cons of incorporating? On the negative side, it will cost your association legal and filing fees to incorporate-- however, this cost is not expensive. Additionally, there will be a little more paperwork for you and/or your property manager in connection with an incorporated legal entity. Every two years, a corporate report, along with a filing fee needs to be filed in the District, listing current directors and officers of the corporation.

(Continued on page 4)

(Continued from page 3)

Should Your Condominium Association Incorporate?

On the positive side, incorporation should provide you with some measure of protection, provided of course, that you act properly and within the scope of your authority.

In closing, generally, there are no adverse tax consequences as to a condominium association incorporating. However, an association should consult with its accountant for advice before doing so.

This article should not be considered legal advise. You should consult with one of our lawyers in connection with your specific Condominium.

2016 ESTATE TAX UPDATE

By: Laurie Pyne O'Reilly, Esq.

Estate tax is a transfer tax imposed on the value of a decedent's assets owned at death. For estate tax purposes, the decedent's assets include both probate assets, i.e., real and personal property ttitled in the decedent's name, and non-probate assets, such as insurance proceeds, joint bank accounts, revocable trust assets, etc. that the decedent had control over before death. Both the federal government, the District of Columbia and Maryland impose estate tax. Virginia currently has no estate tax.

Federal Estate Tax

Federal estate tax is imposed on estates with net value of more than the federal exclusion amount. For 2016, the exclusion amount is $5.45 million (up from $5.43 million for 2015). The estate tax exclusion is unified with the gift tax exclusion in the same amount. That means that for the year 2016, neither estate nor gift tax is owed until combined taxable gifts made during lifetime and net estate assets total more than $5.45 million.

For 2016, the federal estate tax rates remain unchanged. They range from 18% to 40%, with twelve different brackets. However, the maximum (40%) tax rate is reached when the taxable portion of an estate–that is the portion in excess of the lifetime exclusion–is above $1 million.

So for example, for a decedent dying in 2016 with an estate worth 8 million dollars with no taxable lifetime gifts, the estate would be taxed on $2.55 million, with the first million being taxed at graduated rates from 15% to 39% and the remaining $1.55 million being taxed at 40%. The total tax would be approximately $965,000.

District of Columbia Estate Tax

The exclusion amount for 2016 remains at $1 million. The Fiscal Year 2015 Budget Support Act ("BSA") passed by the DC Council in 2014 provided for an increase of the estate tax exclusion up to $2 million, but with an asterisk: the increase was conditioned on the availability of sufficient revenue to "fund" the increase.

As part of the BSA, the DC Council adopted a list of 26 priorities (called "tiers") that will be funded if and when revenue allows. According to the DC Council's Finance and Revenue Committee, revenue has been sufficient to fund up to the 13th tier. (Tiers 1 through 13 include a variety of income and franchise tax reductions.) Increasing the estate tax exemption to $2 million is listed as the 15th tier. Increasing it to conform to the federal estate tax exemption (as indicated above, now $5.45 million) is the 22nd tier. There are no intervening increases in the exemption amount; that is, under the new law

(Continued on page 5)

(Continued from page 4)

2016 Estate Tax Update

the exemption amount will jump directly from $2 million to the federal level. However, it will only happen when the city budget allows for it and the 21 targets with higher priority are met.

The DC Council's Finance and Revenue Committee is "hopeful" that revenue will be sufficient in 2016 to support an increase in the estate tax threshold to $2 million in 2017.

For 2016, the tax rate on taxable estates less than $1 million will be zero and for taxable estates between $1 million and $10 million, will be 8%-15.2%. The maximum rate is 16% on estates valued over $10 million dollars.

Maryland

Law enacted in 2014, phases in increases in the Maryland estate tax exemption amount so that in 2019 it will equal the federal estate tax exclusion. In the meantime, the incremental increases are in the estate tax exemption amount are as follows: (1) $1.5 million for a decedent dying in 2015; (2) $2.0 million for a decedent dying in 2016; (3) $3.0 million for a decedent dying in 2017; and (4) $4.0 million for a decedent dying in 2018.

For 2016 Maryland's estate tax rates remain unchanged topping out at 16%. (Note that, in addition to the estate tax, Maryland imposes an inheritance tax on transfers to beneficiaries who do not fall within the class of close family members.)

Virginia

There is no estate tax currently imposed in Virginia. The estate tax was repealed by legislative act in 2006 at which time estates with assets in excess of $2,000,000 were taxed. The estate tax repeal applies to decedents whose date of death is on or after July 1, 2007.

INCAPACITY OF A RESIDENT: WHAT SHOULD THE BOARD DO?

By: John H. Brillian, Esq.

It is estimated that 26.2% of Americans ages 18 or older, or about one in four adults, suffer from a diagnosable mental disorder in a given year. It is no surprise – given the current woeful state of mental health services in this country – that many of these people are not getting the help that they need. Indeed, how many times have we heard, after the latest tragedy is committed, that the mental health system in this country is underfunded and broken?

This is not to say that people suffering from a mental health condition are violent. In fact, the vast majority of people with mental health problems are no more likely to be violent than anyone else. Nevertheless, the stigma and concern remains. This is especially so when the person who should be on medication to control their condition refuses treatment. A lot of times, such behaviors – whether they be exhibited by someone on the street, in the grocery store, etc. – are ignored. Condominium and Cooperative residents, unfortunately, may live with such matters everyday. Therefore, what is a Board of Directors to do once complaints start coming in from residents regarding a unit owner's odd and troubling behavior?

One approach is for the Board, via the Association, to seek a guardian, and in some circumstances, e.g., the unit owner is behind in the payment of his or her Condominium assessments, a conservator for the unit owner.

(Continued on page 6)

(Continued from page 5)

Incapacity of A Resident: What Should The Board Do?

To initiate such a proceeding, the Association files a Petition for General Proceeding with the Probate Court. Once filed, the Court appoints counsel for the individual, and a visitor/examiner, who is a mental health professional, to determine whether the individual is incapacitated.

An "incapacitated" person is defined in DC Code § 21-2011(11) as an adult "whose ability to receive and evaluate information or to communicate decisions is impaired to such an extent that he or she lacks the capacity to manage all or some of his or her financial resources or to meet all or some essential requirements for his or her physical health, safety, habilitation, or therapeutic needs without court-ordered assistance ..." If it is determined that the unit owner is incapacitated, the Court will appoint a guardian – who is responsible for the well-being of the incapacitated individual, and, if appropriate, a conservator – who is responsible for managing assets.

So the Board has taken steps to address the matter, but complaints still continue to be received. What's next? Contact the Guardian/Conservator? Of course the Guardian should be contacted, but the Guardian cannot force treatment on the unit owner.

The nature of the complaints should guide the Board as to next steps. Facts are important. Also, the governing documents will have provisions regarding nuisance – which is typically defined as a source of annoyance to the Condominium residents which interferes with the peaceful possession or proper use of the Condominium by its residents – or will state something along the lines that no resident shall use their unit or the common element for any unlawful, immoral or improper purpose.

Should the Board have reason to believe that the unit owner may be a danger to himself or others–which belief is informed by the nature of the complaints received–or shows a continued disregard for the requirements set forth for unit owners in the Condominium's governing documents, the Board may have no choice but to file suit against the unit owner alleging that his or her behavior is a nuisance. The Board has a fiduciary obligation to all its residents, and must take action--at the very least--to make sure that the Association is not liable for failing to act.

When filing suit, the Board would not only file a complaint, but would also seek immediate injunctive relief by way of a Motion for Temporary Restraining Order and Motion for Preliminary Injunction. The Motion for Temporary Restraining Order is heard by the Court soon after the action is filed. The Motions, like the Complaint, would ask the Court, among other things, to order the unit owner to cease all unwanted contact and communications with the residents and employees of the Condominium; from engaging in any unlawful or improper conduct in the common elements of the Condominium; and to comply with the governing documents of the Condominium.

As the title of the pleading suggests, the relief sought at this initial stage of the lawsuit is "temporary." Thus, if the Association is successful on its Motion for Temporary Restraining Order, the Court will issue an Order that per the Superior Court Civil Rules will expire in ten (10) days. Because of this, the Court will schedule a hearing shortly thereafter on the Motion for Preliminary Injunction, which if granted, will have the relief sought last the duration of the lawsuit.

(Continued on page 7)

(Continued from page 6)

Incapacity of A Resident: What Should The Board Do?

Many times, the Court will issue an Order, or the parties will agree to the terms of an Order, that will last a full year or more, with the underlying lawsuit being dismissed. Should there be any violation of the Order during that time period, the Association can go back to Court and ask for sanctions.

It is likely you are thinking at this point that the underlying cause which brought about the civil action really has not been addressed. That's the issue. The Association, unfortunately, can only do so much as to the unit owner. As stated previously, treatment cannot be forced, and in the event the unit owner is committed, DC mental health services only have so many resources. Thus, the likely scenario is that the unit owner will be stabilized with medication, after which he or she is back at the Condominium or Cooperative. Once out, the unit owner again stops taking their medication, bringing about the behavior that prompted the action in the first place. It is an unfortunate cycle. But the Association, via the Board, must still act in connection with each incident since it has been put on notice (once again) of a problem.

Certainly, the above is not an exhaustive list for what the Board can do when there is a troubling mental health individual. Moreover, the above discussion, for brevity's sake, is only generic and in no way a detailed account of what could occur in a Probate proceeding or in civil litigation. However, what the Board cannot do is ignore the matter and hope that the unit owner's behavior will improve. Action by the Board is necessary each and every time. The question is always – what should the Board do? The Board has an obligation to address violations of its governing documents, and ensure a pleasant and safe living environment for all of its residents.

CONDOMINIUM FORECLOSURE 101

By: Anthony R. Champ, Esq.

Without a doubt, the most powerful tool a Condominium Association has to recover unpaid assessments is through a condominium association foreclosure. Unfortunately, many Board's are unclear on the process and the potential results. Toward that end, this article summarizes the process.

Step 1: Before deciding on foreclosure the Board must determine if there is any equity in the property. Equity is the value of the property over and above the liens and taxes owed on the property. In other words, if a condominium unit is valued at one hundred thousand dollars ($100,000), it has a mortgage on it of fifty thousand dollars ($50,000) and a tax lien of ten thousand dollars ($10,000) the equity in the property would be forty thousand dollars ($40,000) approximately. To help in determining whether the unit in question has equity, a title report should be ordered. The title report will show the liens and judgments against the property and will aid in determining whether the property is a candidate for foreclosure.

Step 2: Once the Board decides to foreclose, counsel will draft and send the Notice of Foreclosure to the unit owner, via certified mail return receipt requested, and records the Notice in the D.C. Land Records. Notice of Foreclosure will also be sent to all lien holders that appear on the title report.

Step 3: A sale can now be scheduled thirty (30) days after providing the Notice of Foreclosure to the unit owner and recording the Notice in the

(Continued on page 8)

(Continued from page 7)

Condominium Foreclosure 101

D.C. Land Records. We recommend not scheduling before forty five (45) days just to be on the safe side. During this period, the auctioneer will advertise the sale in a local news paper, usually the Washington Post.

Step 4: At the sale date, the Board of Directors sets the minimum sale price. This price should include all past due late fees, attorney's fees, foreclosure fees, any other associated costs and any unpaid taxes. At the sale, one of three things can happen. 1) The property is sold to a new buyer, and the Association is paid in full. 2) No one bids on the property, and the Association cancels the sale (and loses the attorney's fees and auctioneer costs). 3) No one bids on the property, and the Association takes the property back (i.e. becomes the new owner of the unit). In the event that the Association purchased the unit, the Association would be required to pay the recordation and transfer taxes on the full value of the property. In the event that the Association foreclosed upon a property that was subject to a First Deed of Trust, the new owner or the Association (in the event that the Association takes the property back) in many cases would hold the property subject to that First Deed of Trust. In the event that the Association purchases the unit, it would have no personal obligation to pay the monthly mortgage payments to the lender, however, the First Deed of Trust is still in effect. Failure to pay the lender might cause the lender to institute its own foreclosure action (which might be preferable to the Association should it not wish to keep the property). Furthermore, the First Deed of Trust would need to be paid if there is a sale or refinance. Simply, Condominium Associations should stay out of the purchase and sale, unless in rare occasions.

Step 5: Once the sale is concluded, the successful bidder is provided a deed from the Association and becomes the new owner.

As you can see, a condominium association foreclosure is a fantastic tool for bringing a defaulting unit owner into compliance. As such, Associations should seriously consider utilizing this tool to recover unpaid assessments.

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