

# Community Association Management *Insider*<sup>®</sup>

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## Bulk Cable Contract Pushes Association to Bankruptcy

A homeowners association in Daventon, Fla., has filed for Chapter 11 bankruptcy protection, mainly for an unpaid bill of more than \$100,000 to the development's cable company.

The bankruptcy petition listed two creditors holding unsecured claims against the association: an outstanding debt of \$105,305.45 owed to a cable company and \$50,000 for legal services provided by an Orlando law firm.

The community is a 270-unit townhome development that boasts a short drive to Walt Disney World. During the real estate boom, the community tried to remain competitive by offering free cable to all units.

This created problems when the real estate bubble burst. As the number of foreclosed homes continued to rise, the association faced a dwindling pot of monthly dues.

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## FEATURE

## Understanding Federal Energy Tax Credits for Condo Associations

For co-op and condo boards waiting for the right time to make their buildings more energy efficient, this year may be the time to start taking steps to turn their desires into reality. In February 2009, President Obama signed The American Recovery and Reinvestment Act of 2009, often referred to as the Stimulus Bill. This bill made significant changes to energy-efficiency tax credits, which often play a significant role in the decision to make investments in alternative energy such as solar power or to upgrade existing energy-related items such as windows, doors, insulation, and other similar items.

While there has been an explosion of federal tax benefits aimed at homeowners to make such investments, there are a number of unique aspects of how these tax benefits work when the investment is made by condominium associations or cooperative corporations. With the help of Vinay Navani, a practicing certified public accountant with

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## MANAGEMENT TIPS

## Dos & Don'ts for Taking Members to Small Claims Court

Small claims court is used to resolve relatively minor civil disputes in a fair, low-cost, and timely manner. If the money damages that you're seeking are relatively small (typically less than \$5,000, although the amount varies by state) and the association's preference is for a speedy, inexpensive hearing in a less-formal venue, then small claims court may be a viable option.

If the association decides to move ahead with filing a small claims suit against a member, it's important to ensure that a board member or association-employed manager can present your case in an organized, credible manner.

Usually, if an association's property manager is a direct full-time employee of the association, he may represent the association in small claims court. If the property manager is employed by a management

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**Energy Tax Credits** (continued from p. 1)

Wilkin & Guttenplan, P.C., we will provide an overview of these credits and address some of the aspects unique to associations.

**Federal Tax Credit Highlights**

The relevant federal tax credits are divided into two sections of the Internal Revenue Code. Section 25C, Credit for Nonbusiness Energy Property, allows for a tax credit of 30 percent of the costs of certain residential energy-efficient investments such as new windows. However, federal tax credits applied under this section are subject to a maximum credit of \$1,500 per taxpayer over 2009 and 2010.

The second section is Section 25D, Credit for Residential Energy Efficient Property, which allows for a tax credit of 30 percent of the costs for certain alternative energy investments such as solar and geothermal power.

With the passage of the bill, not only has the tax credit been raised from 10 percent to 30 percent, it has also been extended to 2010 as well. As a result, the credit applies to purchases and improvements made between Jan. 1, 2009 and Dec. 31, 2010.

**Eligible Energy-Efficiency Investments**

It is not enough to simply buy new building components such as windows or doors to qualify for the 30 percent credit. The components must meet specific guidelines for energy savings. In addition to windows, doors, and skylights, other typical condominium building components and products eligible for the tax credit include central air conditioning units, heat pumps, furnaces, boilers, water heaters, reflective metal and asphalt roofs, and insulation, which includes caulking, weather stripping, and foam sealants. Alternative energy components such as geothermal heat pumps, solar water heating and power, and biomass stoves are also eligible.

If the product qualifies, the manufacturer must provide you with a Manufacturer's Certification Statement. This is a signed statement from the manufacturer certifying that the product or component qualifies for the tax credit. For tax years 2009 and 2010, taxpayers must keep a copy of the certification statement for their records, but do not have to submit a copy with their tax return.

Here are the qualifying standards for windows and doors:

**If installed from Jan. 1 to May 31, 2009:** The windows or doors must meet Energy Star standards, which are less stringent than the requirements for those installed after June 1, 2009. Energy Star-rated windows typically include such features as multiple panes with gas-filled spacing, special coatings to reflect infrared light, and warm edge spacers to reduce heat flow and condensation.

**If installed June 1, 2009 or later:** The windows' or doors' U-factor and Solar Heat Gain Coefficient (SHGC) both must be less than 0.30. The U-factor measures the rate of heat transfer and how well a window or door insulates. And the SHGC measures the amount of solar energy admitted and how well the window or door blocks heat caused by sunlight.

### Impact to Associations

According to Navani, due to the unique way associations are taxed, most do not pay significant federal taxes, and accordingly, the value of a tax credit is usually not attractive. However, in the case of a qualifying investment made by an association, the two credits are considered to be made by each member based on their "proportionate share" of expenses made by the association.

For example, if a 100-unit condominium association paid \$40,000 for replacement windows that met established energy-efficient standards, each unit owner's apportioned cost would be \$400. The 30 percent tax credit for that project would therefore amount to \$120 for each unit owner. The tax credits for the window replacement project and other qualifying energy-improvement measures combined would max out at \$1,500 per taxpayer for 2009 and 2010.

Associations that seek to take advantage of these benefits will have to balance the fact that the funds needed for the investment will come from the association, and the tax credit, if any, will be claimed by members.

### ► FAQs: Federal Energy Tax Credits

#### Q Are installation costs covered by the tax credit?

**A** No, the tax credit does not cover the installation costs for storm doors, windows, or doors. However, it covers both the product and installation costs for heating and cooling equipment.

#### Q If I purchase a qualifying window product from a contractor who is also installing it, how do I separate the product cost from the installation cost to determine the correct amount for the tax credit?

**A** Ask for an itemized bill that separates out product costs from installation costs. If possible, ask the contractor before contracting his services if he will provide an itemized bill to help ensure he provides you with the correct information so members can claim the proper amount for the tax credit.

#### Q Can I include sales tax when determining the total cost for the tax credit?

**A** Yes, sales tax can be included for all covered qualifying energy-efficient components.

#### Q What is the difference between a tax credit and a tax deduction?

**A** Unlike a deduction, which reduces that amount of taxable income, a tax credit directly reduces the amount of tax a member has to pay. If a member doesn't pay any taxes, the member cannot get the tax credit for energy efficiency.

#### Q What is a Manufacturer's Certification Statement?

**A** A Manufacturer's Certification Statement is a signed statement from the manufacturer certifying that the product or component qualifies for the tax credit. Taxpayers must keep a copy of the certification statement for their records, along with their receipt, but they do not have to submit a copy with their tax returns.

Navani recommends that should a condo association decide to upgrade to more energy-efficient building components, the association should provide a letter to each member informing him of the details of the investment and his proportionate share so that he could claim the credit on his personal return using IRS Form 5695, Residential Energy Efficient Property Credit.

Associations must caution members that since the credit is claimed on the member's individual return, there could be factors unique to the resident that would cause the credit to be limited. For

example, for credits to be of use, there must be a tax liability for the credit to offset. In other words, these credits are "nonrefundable" credits—which means that if the amount of the credit is greater than the amount of tax due for the year in which the credit arises, the excess amount does not create a refund check.

Furthermore, under current law, the credits will not be available to offset the Alternative Minimum Tax (AMT) in 2010. For 2009, the credits are available to reduce both regular tax as well as the AMT. Therefore, in 2010, these

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## Energy Tax Credits

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credits will have no value to the increasing number of taxpayers who are subject to the AMT. Of course, it is possible that future tax legislation could change this, but there are no assurances that this will occur.

The above represents a summary of these credits and does not

address all of the particular details that may be relevant to your association's situation. Navani recommends speaking with your association's tax professional and to consult with an engineer or architect to consider what options are best for your building.

For more information on federal tax credits for energy efficiency, visit Energy Star's Web site at [www.energystar.gov/taxcredits](http://www.energystar.gov/taxcredits).

### Insider Sources

**Vinay Navani, CPA, MBA, MST:** Shareholder, Wilkin & Guttenplan, P.C., 1200 Tices Lane, E. Brunswick, NJ 08816; [www.wgc-pas.com](http://www.wgc-pas.com).

### For more information, visit:

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Search Our Web Site by Key Words: tax credits; energy efficiency; alternative energy; The American Recovery and Reinvestment Act of 2009; Energy Star

## Management Tips (continued from p. 1)

company that oversees multiple communities, the court may not allow this manager to represent the association.

With the help of Washington attorney Thomas McGarry, we've put together a few dos and don'ts to help prepare a board member or the on-site association manager for the hearing.

### ✓ Evaluate Whether Case Is Simple Enough, Meets Requisites

The type of claim an association may file in small claims court depends on the rules of the jurisdiction. In California, for example, associations can use small claims court for the collection of fines and assessments when a member has lost the title to the property. An association may also file a claim for property damage caused by a member. However, in California, filings are not permitted for governing document violations, whereas other jurisdictions may authorize the judge to order an action, such as complying with

the deed restrictions, even when no money is involved.

Associations considering small claims court should perform the necessary research. Although small claims court actions are not subject to all the procedural requirements that county and district court lawsuits are subject to, there are requirements that must be met when a small claims lawsuit is initiated. States have differing limits on dollar amounts of claims. There may be limitations on the number of lawsuits filed and who can represent the association.

Another consideration when deciding on whether to file a small claims lawsuit is the complexity of the issues. As a general rule, complex cases are not appropriate for small claims court.

### ✓ Make Sure Claim Is Reasonable and Supported by Evidence

If your claim involves monetary damages for property that was harmed by a member, you will

need to establish what it cost and why the member is liable for it.

Your claim must be reasonable—the cost of damaged property should be assessed at a depreciated value. For instance, let's say that the property damage includes a 15-year-old carpet that was in a common area. Can you charge the member for a brand-new carpet? "Probably not," McGarry says. "It would be the depreciated value of the carpet. What was the life left of the carpet that was destroyed? That probably is the measure of damages. Remember, you are seeking monetary damages and not unjust enrichment."

### ✓ Organize Documentation Chronologically

You will need to bring to court documents and records that will help you to prove your case. Those may include canceled checks, receipts, notices sent to the member, repair bills, and photos of property damage.

Keep in mind that the judge is like a blank page—the first chance a judge may have to look at your case is when he opens the file at your hearing.

Organizing your documents chronologically will help you to present your case in a logical, easy-to-follow timeline. And while starting at the beginning is important, “Focus on what is relevant. You have to be able to communicate your claim to a judge as concisely as possible,” McGarry says.

### ✗ Don't Mark Up Your Evidence

Don't mark the documentary evidence. If you find that making notes and comments on photos or notices will help during your testimony, make a copy of the documents first.

“It's a good practice to make several copies of your documentary evidence—for yourself, for the opposing party, and for the judge to mark up,” says McGarry. However, keep in mind that the originals will be filed with the court, and “we want a piece of paper that shows what it shows, and is free from any comment,” he says.

### ✗ Don't Waste Time in Court

Time is very limited in small claims court. For instance, in Spokane, each case may be allotted only 20 minutes. You may have as little as 10 minutes to present your case.

Again, make sure that your documentary evidence is organized so that you can present it efficiently. The judge usually may listen for a minute or two,

and then may start asking questions, so be prepared. Know your case inside and out. You should be flexible enough to answer the judge's question and still assert your claim.

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**PRACTICAL POINTER:** Because of the time constraints associated with small claims court, it's helpful to begin your testimony with an opening statement that summarizes your case, says McGarry. For instance, “this is a claim for unpaid assessments” instantly provides a framework for the judge.

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### ✓ Treat the Court with Respect

Being respectful in court adds to your credibility. McGarry also offers the following basic tips:

- Refer to the judge as “your honor” or “judge,” not “ma'am” or “sir.”
- Wear appropriate clothes to court—no printed T-shirts, shorts, or hats.
- Don't chew gum (let the opposing party look bad!).
- Don't bring food or drink into the courtroom.
- Turn off your cell phone.

Remember, regardless of the fact that this is a small claim, you should present yourself in a businesslike fashion. “These are the sorts of things that show respect or disrespect to the court,” he says. “And sometimes credibility is what is required to tip the scales in your favor.”

### ✗ Don't Interrupt the Member

One thing that is frustrating to the court and will quickly destroy your credibility is interrupting the opposing party.

“Everyone gets a chance to talk,” says McGarry. “If the opposing party says something that you don't agree with, make a note of it and then point it out when it's your turn to speak, but never interrupt someone.”

### ✓ Do Your Homework: Sit Through a Docket

The best way to prepare for a small claims case is to sit through a couple of dockets, McGarry says. “Television shows with bombastic ‘judges’ and angry litigants are not an accurate portrayal of how most small claims courts work. These shows are entertainment, not formal legal proceedings.”

There is no better way to get a sense of how the proceedings work than sitting through a docket. Be sure to take note of how the judge behaves, what information he's looking for, and what he likes or doesn't like. Also, in Washington state, every county publishes a small claims information brochure, McGarry says. Be sure to check with your local court system for similar publications. Sometimes the information is available online. You should at least obtain as much information from the court as possible so that you will know what to expect and how you must proceed.

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#### Insider Source

**Thomas McGarry:** McGarry Law Office; [www.mcgarrylawoffice.com](http://www.mcgarrylawoffice.com).

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## RECENT COURT RULINGS

### ► Town Not Responsible for Maintaining Water Lines on Private Property

**Facts:** A condominium association sued a town over who was responsible for repairing and maintaining the water lines from the public right-of-way to the community's shut-off valve. Usually, these shut-off valves are located on a public right-of-way or as close to it as possible. However, for an undetermined reason, the association's developer placed some of these valves well within the property lines of each unit owner. The trial court ruled for the town, and the association appealed.

**Ruling:** A New Jersey appeals court ruled for the association.

**Reasoning:** The association tried to argue that the town provides water service and maintains water lines throughout the city and that the town could not deny its obligation to provide these services to the association. The judge ruled that the town has consistently interpreted the applicable ordinance as requiring it to maintain water lines only to the extent they are located on public lands. The court found this to be reasonable.

The town presented evidence of a consistent service policy that it seeks to apply to the association: maintaining water lines up to the public/private property line, whereupon members are responsible for any maintenance on their own land.

■ Kip's Ridge Condo. Assn. v. Township of Montclair, July 2009

### ► Association Not Liable for Slip-and-Fall Injury

**Facts:** A member's housecleaner filed a personal injury lawsuit against the association. While cleaning one of the condominium units, the housecleaner slipped and fell on a wet tiled exterior walkway. The walkway is a common area that leads from the member's condominium down a stairway to the door of his garage. The lawsuit alleged that the association knew about the danger created by the wet tiles on the walkway but failed to make repairs. The trial court granted a judgment without a trial in the association's favor. The housekeeper appealed.

**Ruling:** A Washington appeals court agreed with the lower court's ruling.

**Reasoning:** Under Washington law, the association would have been liable for a dangerous condition of the common areas if it knew about, or by the exercising reasonable care would have discovered, the dangerous condition. The housecleaner's employer testified that he talked to the association president about the puddles that collected on the walkway when it rained. The housecleaner further testified that she did not slip because of a puddle of water but because the tiles on the walkway were wet. Based on the testimony, the court ruled that the housecleaner presented no evidence that the association either knew or should have known of the alleged danger created by rain on the tiled walkway.

■ Garron v. Pier Point Condos. Assn., July 2009

### ► Attorney-Member Disqualified from Representing Other Member

**Facts:** An association member who was also a lawyer filed a lawsuit against the association for alleged improprieties surrounding a special assessment for repairs and maintenance. Under the settlement agreement, the member agreed to write a letter to all members stating that he found no evidence of any self-dealing or any misappropriation of funds. The member refused to sign the letter, and several months later represented another couple living in the community. This lawsuit essentially alleged the same facts and causes of action.

During the course of representing the couple, the member discovered that the association's corporate status had been suspended for failure to file a statement of information with the secretary of state. The member then created a new and separate corporation using the same name as the association and wrote a letter to the board indicating that he took the corporate name, that he was no president of that association, and notified them that the use of his corporate name was forbidden and unauthorized.

The board then sent a letter to all members of the association informing them of the issues with respect to the corporate status and that they should not pay assessment monies to the member. The member responded by issuing a letter to all members and three board directors who were named parties to the lawsuit. In this letter, he threatened to sue anyone

who made statements that he attempted to collect any money.

The association asked the court to disqualify the member as counsel for the couple. The trial court granted the association's request, and the member appealed.

**Ruling:** A California appeals court agreed with the lower court's decision.

**Reasoning:** The court found that the member's letter to all other members intimidated a significant percentage of the members and prevented them from assisting the association in defending this case. The tone of the letter was very harsh, and the letter suggested that the member was sending it as legal counsel for the couple rather than purely as a non-attorney. The court further decided that the only way to remove the intimidation is to disqualify the member as the lawyer.

■ Sol v. Maison De Ville Condominium Assoc., July 2009

### ► Court Defers to Board's Judgment Regarding Common Area Maintenance

**Facts:** A dispute arose between a member and his association regarding maintenance of the common areas. The member claimed that the board breached its duties under the community's governing documents by refusing to maintain some concrete, stairs, and brick areas near the member's home.

The suing member provided photographs of stairs with worn-down edges. The stairs also had surface rust stains showing a lack of maintenance of the concrete. The member introduced further evidence that the board was aware of the problems and a subcommittee to address the problem presented a recommendation to the board that the association resurface the areas with a particular coating product. The board had decided to go with another cheaper product and to leave certain areas uncovered and in a state of disrepair. The trial court ruled for the association, and the member appealed.

**Ruling:** A California appeals court agreed with the lower court's ruling.

**Reasoning:** The evidence showed that the common area maintenance and repair issues in this lawsuit were matters entrusted to the board's discretion. The governing documents broadly require the association to operate and maintain or provide for the operation

and maintenance of all common areas. It does not specify the means or materials the board must use in maintaining the common areas. And it does not provide any guidelines for prioritizing or scheduling the community's maintenance or repair work.

The court also found that the board reasonably investigated complaints about the deterioration of the common areas by appointing a subcommittee to determine the extent of the repair and provide estimates as to the cost of repair. In addition, there was no evidence that the board did not act in good faith and without regard for the best interests of the community.

■ Cohen v. Villa La Jolla Townhomes, July 2009

### ► Board of Directors Acted in Association's Best Interest

**Facts:** A member sued the association and its board members for allegedly breaching their fiduciary duties by rubber-stamping a neighbor's application to build a home on an adjacent lot of land. The member also alleged that the neighbor's planned development would violate the governing document by interfering with the member's views, outlook, and surroundings. The association asked the trial court for a judgment without a ruling in its favor, and the trial court granted the association's request. The member appealed.

**Ruling:** A California appeals court agreed with the lower court's decision.

**Reasoning:** The court found that the undisputed evidence showed that the directors did not act arbitrarily in approving the neighbor's plan. The association held at least five board meetings that were open to all association members, reviewed letters from the suing member raising his concerns, considered written comments from other members both supporting and opposing the plans, sent letters to the suing member explaining their actions, heard a presentation by the neighbor's architect, employed legal counsel who rendered written legal advice, and reviewed a building permit issued by the city before determining that the proposed development did not violate the community's governing documents. The court ruled that the directors acted in good faith in what they believed was in the association's best interest, and therefore the directors did not breach any fiduciary duties they had to the association.

■ Sharp v. Alta San Rafael Assn., July 2009

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