Community Association Management Insider®

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INSIDE THIS ISSUE

Association Forced to Sell "Heart of Community"

A Fairfax, Va., homeowners association spent big bucks on a small problem—and bankrupted itself in the process. The 44-unit townhouse community shelled out almost $400,000 in legal fees to fight a four-year battle with two unit owners who in 2008 placed in their yard an election sign that was four inches taller than the association's covenants allowed.

After the owners were fined for the infraction, the association then passed a resolution allowing the board to render fines for violating HOA guidelines. The owners refused to pay the fines then assessed against them, claiming that the board didn't have the legal right to assess fines at the time the election sign became a point of contention.

The board also rejected the owners' plans for a deck and a roof, after which the owners sued the association, claiming that they didn't have to pay the fines and that their projects were baselessly

(continued on p. 2)

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FEATURE

Tailor ADR Techniques to Specific Type of Dispute

One of the major advantages of living in a planned community or condominium is that the homeowners association may be able to help resolve community-related conflicts that arise. Determining the best way to do so is part of an association's responsibility. That's where alternative dispute resolution (ADR) comes in. ADR can address issues that don't truly require a trip to court. It's important for an association to consider the appropriate ADR techniques—which include, but aren't limited to, conciliation, mediation, and non-binding or binding arbitration—for each situation.

Suggest to your association that it consider using the following ADR methods to resolve conflicts. And explain which methods are best suited to the types of disputes that might arise.

Use Conciliation for Assessment Collection Disputes

Associations shouldn't automatically jump to the two widely known ADR methods of mediation and arbitration when facing a dispute with an owner over whether he owes association assessments or other

(continued on p. 2)

LEGAL COMPLIANCE

Enforce Home Business Rules Consistently for All Members

Home businesses are being operated more often than ever before, as a cost-saving measure or because it's more convenient for the business owner to stay at home. But some associations restrict the kinds of businesses members can operate in their homes or prohibit home businesses altogether.

If your association allows home businesses but imposes rules that restrict certain aspects of a business—for example, the hours it can operate and how many clients it can accommodate—you need to be especially careful to apply those rules across the board for all business owners. Otherwise, the association—and even its individual board members—could be accused of discrimination, exposing you to a Fair Housing Act (FHA) discrimination lawsuit, and possibly other state-specific discrimination law violations.

(continued on p. 8)

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Tailor ADR Techniques (continued from p. 1)

fees. "There are ADR techniques beyond mediation and arbitration that can be used in community associations," says New Jersey community association attorney Ronald L. Perl. Conciliation, which is one of the least formal methods of ADR, really just involves a more formalized consultation—a meeting—in an attempt to resolve a dispute, he says.

"In New Jersey, there are statutes requiring all homeowners associations, cooperatives, and condominiums to make available ADR as an alternative to litigation in certain disputes—for example, disputes involving rules violations and conflicts between homeowners," explains Perl. The Condominium Act in particular uses the term "housing related disputes" to refer to those types of disputes. That term has recently been interpreted broadly by an appellate court to mean any dispute that arises in the context of the condo form of ownership, says Perl.

"At least *that* court has interpreted the requirement that ADR be available now to apply to assessment collection, and that's an example of where we've started to use conciliation more," Perl adds. "To use arbitration or mediation in an assessment collection context is overly and unduly burdensome and would really clog up the lifeline for associations, which is their assessments," says Perl. He recommends that associations offer ADR in the form of conciliation for assessment disputes, such as those over whether an assessment is owed or the payment was late. (Conciliation isn't useful in cases where the amount is undisputed but an owner asserts that the assessment is illegal.)

During the conciliation process, an owner makes an appointment with a member of the managing agent's bookkeeping staff and brings with him all of the documentation showing proper payment. The bookkeeping staff member has the association records at hand and would be able to compare, on the spot, cancelled checks with the association's bookkeeping entries.

Association Forced to Sell (continued from p. 1)

rejected. A judge ruled in the owners' favor on the fines issue, indicating that the association couldn't claim powers that weren't laid out previously in the covenants, but the improvements matter was split into another lawsuit. A judge ruled that the board's votes pertaining to the projects were improper because they came at a secret meeting and followed arbitrary standards. A series of appeals and other proceedings have drained the association, which has had to raise community dues from $650 to about $3,500 per year, in an effort to cover the cost of those legal bills.

To help pay off its debt, the association put up for sale an area called "the square." The common area previously was described as "the heart" of the community, but social events are no longer being held there. And until the square is sold, individual members will be paying out of pocket for the plot's water, electricity, and maintenance. ♦

Conciliation is a productive, but much overlooked, ADR technique in the community association world, says Perl. It works well because it creates a "meeting of the minds"—the owner and the association's managing agent have to have all of their data readily available during this conference; if all of the necessary data is together it should be clear exactly what's owed, if anything, whether late charges were properly assessed, or whether the payment was on time, he stresses. These issues can all be worked out efficiently using conciliation, rather than the unproductive scenario where an owner calls the managing agent to argue about an alleged discrepancy.

What's the manager's role in conciliation? Should you attend the meeting? Not necessarily. Whether you need to attend the meeting will largely depend on how much access to or control over the association's financial records and other relevant information you have. The person representing the association generally is a member of the managing agent's accounting or bookkeeping staff, not the site manager, and needs to be familiar with the accounting aspect of things. If a site manager who doesn't have familiarity with the association's account records has to check with other parties about necessary information during the meeting, it undermines the whole purpose—to quickly and efficiently settle the matter at once.

"We prefer a system where the management company designates a knowledgeable person who has full access to the records, knows them, can do the necessary research on the spot if possible, and can actually come to some resolution with the owner. If you have a person with control over the financial records, that person can resolve that kind of thing or at least agree where the difference is, in which case it's not settled but at least the issue has been narrowed," says Perl.

PRACTICAL POINTER: A conciliation meeting can also be conducted by phone, but if the management company is local, it should be done at the management company's office where both parties have access to a computer in case it becomes necessary to access information that way. Statewide management companies can't send managing agents all over the state for conciliations. "It's reasonable to give the option of doing this by phone or going to the management company," says Perl.

Use Internal Process for Neighbor Conflicts, Rules Violations

The New Jersey statute also considers neighbor-to-neighbor disputes, such as conflicts over things like noise and parking, to fall under "housing related disputes," which can be resolved less formally.

"Association rules and covenant enforcement issues also fall in this category. When the association becomes aware of an alleged violation, it puts the owner on notice, and she may dispute whether it's really a violation," Perl says. An internal process can resolve arguments over whether an owner's actions have truly conflicted with the association's rules. It could be used, for example, when an owner, by law, can't be stopped by an association from making an environmentally beneficial modification to his unit, but the association argues that the aesthetics of the equipment or the manner in which it was installed doesn't comply with its regulations governing the installation or use of that equipment.

"There should be an internal process that allows an owner to contest an alleged violation and state the reasons why he thinks his actions conformed with the association's regulations, and also allows the association's representative (in the example above, the architectural control committee) to say why it thinks the owner has been noncompliant with regulations.

Usually, this process involves a separate covenants committee comprised of other unit owners—but not board members—who have volunteered making a determination one way or another. "Alleged rules or covenant violations are areas where this type of ADR is widely used—especially in New Jersey, where the law requires that ADR be available," says Perl.

Use Mediation, Arbitration for Developer Claims

Mediation and arbitration can be used for many kinds of association disputes, including those with contractors, builders, and developers.

"ADR should be available for everything from contractor disputes to developer construction defect lawsuits," says Perl. "I've long been a proponent for ADR, particularly mediation, in associations because I believe that mediation is effective," notes Perl, who actively mediates and is very involved in the Community Associations Institute (CAI) mediation program.

In a somewhat controversial move, some builders are actually including mandatory ADR in their governing documents and sales contracts. A process for dealing with transition-related disputes—that is, alleged construction defects or alleged monetary claims—between associations and builders that arise from the

(continued on p. 4)

Tailor ADR Techniques

(continued from p. 3)

development process is often put right in the master deeds or declarations.

"I've come across a number of cases over the last five years where the association has had to arbitrate its transition claims because of provisions in the *unit sales* contracts," Perl says. That's because under certain circumstances, these provisions may be held to affect not only the owner who's purchasing the unit, but also the association of the community where it's located.

"When a developer signs a sales contract with a purchaser, it can put in the sales contract that any dispute arising from the contract involving construction or other claims must be arbitrated," says Perl. And courts have sometimes held that if all or most of the owners' sales contracts contain such an arbitration provision, where the association is merely acting as the representative of the owners, even claims brought by the *association,* not an owner, have to be arbitrated.

Many declarations now contain not only a requirement for ADR, but also a specific process the association has to go through. (This is state-specific, however, so make sure that you and the association talk with your attorney about these issues before taking any action.)

For example, some states have "right to cure" legislation. Under this legislation, the documents contain a process for dispute resolution that's outside the court system and is mandatory before an association can go to a court system there, says Perl. Once the developer relinquishes control and the project is completed, the association is required to hire a professional engineer, architect, or licensed inspector to do an inspection of the property and make any and all claims that result from that inspection during a specific time period (usually much shorter than the statute of limitations). The builder must respond during a certain time period and based on that response, there must be some kind of ADR process that attempts to resolve any conflicts or outstanding disputes.

While the right to cure legislation hasn't caught on much in the Northeast, Midwestern and Western states—where there's much more, and increasingly aggressive, defect litigation—have considered or adopted it. But legislation isn't necessary, notes Perl. "Builders can build that process into a declaration, and owners, by accepting title to that unit, may be deemed to have agreed to that process," he points out.

Include ADR in Service Contracts

Associations, which are in essence like businesses, can't afford to be in court frequently. In service contract disputes, arbitration and mediation are two ADR techniques that can be used to settle matters to the association's and the service provider's satisfaction without costly litigation.

"An ADR provision in a service contract may be appropriate, so if there's a dispute, we at least give ADR a chance," says Perl. "Arbitration and mediation provisions encourage the parties," he adds. Although mediation is voluntary in the sense that the parties don't have to accept the outcome, it's a good option to offer, he recommends.

"I don't think there's ever a disadvantage to mediation—if you can sit down across the table with a facilitator and try to work something out it's a no-lose situation because all you've invested is a relatively small amount of money: your lawyer's fees and half the mediator's cost," he stresses. This is certainly worth it if you can resolve a case, and the mediation alternative is a great way of attempting to do this.

If your association chooses to use mediation to try to settle certain types of disputes, it can adapt our Model Clause: Carefully Craft Mediation Provision, to use in its contracts to require that the matter be mediated before using arbitration or litigation to settle it.

Binding arbitration has some disadvantages as compared to litigation. For example, the right to appeal is quite limited, notes Perl. There has to virtually be fraud or a gross misapplication of the law by the arbitrator to be eligible for an appeal. But it can stop a party with deeper pockets from using the strategy of dragging out a case to exhaust the other side's resources.

While successful appeals from binding arbitration are exceedingly rare because the grounds for which a court can overturn an arbitration award are extremely limited, that's also a good thing, says Perl. "There's finality," he points out. "You get to an arbitrator, you get a resolution, and it gets done. And without an appeal, you can file the arbitration award as a judgment in court, and it's enforceable as if it had been tried through the judicial system," says Perl.

If the parties are leery about committing to binding arbitration, another option is non-binding arbitration. There, the arbitrator hears the evidence and renders a

decision, but either party is free to reject it and move on to another form of ADR or to court. The advantage of non-binding arbitration, though, is that it informs the parties of how at least one neutral person views their case and so may convince them to accept the arbitrator's non-binding decision or otherwise settle the matter.

EDITOR'S NOTE: Be aware that if the association makes ADR an option—or mandatory—for all contractors, it will probably apply to association disputes with you or your management company, because a management company is a contractor. Check your contract with the association to see if ADR is mentioned.

Weigh pros and cons of arbitration. Arbitration has a lot of advantages, but it's not always faster or less expensive than other resolution options. A significant case can drag on for years and wind up being more expensive than litigation, especially with a three-arbitrator panel, because arbitrators typically charge high hourly rates. And if you use a dispute resolution organization to oversee and conduct your arbitration, you'll probably pay filing and administrative fees. "It's a costly process and sometimes takes longer," warns Perl.

Coordinating the schedules of lawyers and arbitrators can also be tricky. And while pretrial discovery isn't as extensive as in the court system, it's still allowed at the discretion of the arbitrator or arbitrators. (In a complicated case it's usually allowed.)

You need to be careful if you're going to write arbitration provisions into your agreements, Perl emphasizes. "You should first consider whether, in light of the

(continued on p. 6)

MODEL CLAUSE

Carefully Craft Mediation Provision

This Model Clause, drafted by New Jersey community association attorney Ronald L. Perl, can be used to require mediation before resorting to arbitration or litigation to solve an association-related conflict with a construction contractor. Show this clause to your attorney before using it in your contracts.

MEDIATION

MEDIATION. Claims, disputes, or other matters in controversy arising out of or related to the Contract shall be subject to mediation as a condition precedent to binding dispute resolution.

1. The parties agree to attempt to resolve any dispute, claim, or controversy arising out of or relating to this Agreement by mediation, which shall be conducted by a mediator selected in the manner provided below. In addition, the parties agree that their good faith participation in mediation is a condition precedent to pursuing any other available legal or equitable remedy, including litigation, arbitration, or other dispute resolution procedures.

2. Either party may commence the mediation process by providing to the other party written notice, setting forth the subject matter of the dispute or claim as well as the relief requested. Such notice shall also contain the name of that party's Designee as hereafter defined. Within ten (10) days after the receipt of the foregoing notice, the other party shall deliver a written response to the initiating party's notice, together with the name of the responding party's Designee.

3. The mediator shall be selected in the following manner: Each party shall designate an individual as its "Designee," who shall be an architect, attorney, or engineer licensed to practice in [*insert state name, e.g., New Jersey*] and experienced in the practice of commercial or construction mediation ("the Designees"). The Designees shall confer within seven (7) days after the responding party appoints its Designee and in good faith appoint an individual with experience in commercial or construction mediation, to serve as the mediator pursuant to this agreement. Each party shall pay any fees due to its respective Designee. If the Designees cannot in good faith agree upon a mediator, then the parties agree to ask the Assignment Judge of [*insert county name, e.g., Monmouth County*] to appoint a mediator. Notwithstanding the foregoing, the parties may waive this appointment process by agreeing upon a mediator within the ten (10)-day period after the initial notice of mediation.

4. The initial mediation session shall be held within forty (40) days after the initial notice. The parties agree to share equally the costs and expenses of the mediation (which shall not include the expenses incurred by each party for its own legal representation in connection with the mediation).

5. The parties acknowledge and agree that mediation proceedings are settlement negotiations, and that, to the extent allowed by applicable law, all offers, promises, conduct, and statements, whether oral or written, made in the course of the mediation by any of the parties or their agents shall be confidential and inadmissible in any subsequent proceeding. However, evidence that is otherwise admissible or discoverable shall not be rendered inadmissible or non-discoverable as a result of its use in the mediation.

6. The provisions of this section may be enforced by any Court of competent jurisdiction, and the party seeking enforcement shall be entitled to an award of all costs, fees, and expenses, including reasonable attorneys' fees, to be paid by the party against whom enforcement is ordered.

Tailor ADR Techniques

(continued from p. 5)

advantages and disadvantages, arbitration is an appropriate alternative for your organization's needs. Then write the actual provisions carefully and make sure that if they're needed, the performance is actually what you anticipate it'll be," he says.

You can do that by controlling how the arbitrators are selected and who can serve as an arbitrator. For example, Perl likes to include a provision especially in smaller contracts that provides for mediation and, if the parties can't settle the matter that way, then arbitration.

For smaller types of disputes, a single arbitrator mutually agreed upon by the parties may be acceptable. However, in larger disputes it's common to use a three-arbitrator panel. When a three-arbitrator panel is desired, Perl makes sure that the arbitrators are selected in the following way: Each party to the dispute selects a qualified arbitrator, and these two arbitrators pick a third arbitrator to serve with them. If a third arbitrator can't be agreed upon, an assignment judge of the county where the association exists will assign an arbitrator.

The process is designed to make it simple, efficient, and cost effective. Associations really have to think about these things in advance, says Perl. It's a matter of experience and considering where the process worked or didn't work in the past. For instance, if your association has dealt with cases moving slowly, setting timelines within which certain aspects of the process must be completed, such as scheduling the arbitration hearing within so many days and requiring a decision to be issued within so many days thereafter, helps keep the process on track.

Customize contracts. "Associations can be creative when deciding which ADR methods to choose," says Perl. "It's a mistake to take an arbitration provision off the shelf and just use it in every contract," he warns. "You need to think about what the nature of the contract is, who the parties to the contract are, what services will be performed, and what kinds of disputes could arise, he says.

For example, Perl likes to put short time frames into smaller contracts, such as landscaping contracts. If there's a dispute with a landscaping contract, the hearing gets scheduled within 30 days and the decision is issued within 15 days thereafter. On the other hand, those time frames won't work for a complicated construction defect case. "Really think about what the contract is that you're inserting the provision into," says Perl. "It needs to be customized," he emphasizes. ♦

Insider Source

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RECENT COURT RULINGS

➤ Agreement to Pay Assessments "Implied in Fact"

Facts: An association that owns and maintains the public areas within a gated community and provides services to the residents of that community sued a homeowner for dues and assessments. Following a nonjury trial, a court ruled in favor of the association. It ordered the owner to pay over $3,000 to the association. The owner appealed.

Decision: A New York appeals court upheld the lower court's decision.

Reasoning: The owner argued that she wasn't obligated to pay the dues and assessments charged by the association because the previous owner from whom she purchased her property didn't inform her of that obligation and because she never entered into an agreement to pay the association's charges.

The appeals court determined that the owner's agreement to pay the charges, however, was "implied in fact" by her purchase of property within the association's gated community.

- Sea Gate Assn. v. Zelinskaya, February 2013

➤ Association Not Entitled to Apportion Attorney's Fees

Facts: Water leaks in the common area of a condominium building damaged an owner's unit. The owner sued the association and the building's developer. After a jury trial, the jury found that both the developer and the association were negligent and that their actions were the direct cause of the damage. The jury attributed 80 percent of "fault" to the developer and 20 percent to the association—that is, the developer would be responsible for paying 80 per-

cent of the damages and the association would be responsible for paying 20 percent. But the association was ordered to pay *all*—not just 20 percent—of the owner's attorney's fees. The district court denied the association's request to apportion attorney's fees according to the jury's "fault" allocation. The association appealed.

Decision: A Minnesota appeals court upheld the trial court's decision.

Reasoning: The district court rejected the association's argument because state laws provide for an award of reasonable attorney's fees against any person who is found to have breached the governing documents of a homeowners community. The appeals court agreed with that decision, stating that the court wasn't required to apportion attorney's fees between two parties who were at fault, nor was the association entitled to shift some percentage of attorney's fees to another party in the case.

- McMorrow v. R. E. C., Inc., February 2013

➤ Association Owed No Duty of Care to Injured Guest

Facts: A condominium unit included access to a wood rooftop deck enclosed by a railing. The owner of the unit held a party on the deck. One of the party guests climbed over the railing and walked across an unimproved portion of the roof where he fell through an airshaft and was injured. The guest sued the condo association for negligence. The association asserted that the incident wasn't foreseeable and that it owed no duty of care to the guest. The association asked a trial court for a judgment in its favor without a trial. The trial court granted the request, and the guest appealed.

Decision: An Illinois appeals court upheld the trial court's decision.

Reasoning: The appeals court agreed with the trial court that the association wasn't negligent. The trial court had made its ruling based on two factors: (1) the guest's status at the building at the time of the accident; and (2) the duty of care that the association owed to him based on that status. The appeals court noted that the liability of a landowner, such as the association, "has been set in terms of duty." Those who enter onto a property are generally divided into three fixed categories: trespassers, licensees, and invitees–and the landowner has specific duties regarding persons within each category, said the trial court.

The trial court had determined that the guest was a "trespasser" as a matter of law at the time of the accident. "A trespasser is defined as 'a person who goes upon the premises of another without express or implied permission or invitation,'" noted the trial court. The guest argued that he was an invitee, not a trespasser.

The trial court disagreed. "An invitee loses his status as an invitee and becomes a trespasser when, after being invited onto the premises, he goes to another area beyond the scope of the original invitation," it stated. "If an invitee deviates from the accustomed way or goes to a place other than that place covered by the invitation, the owner's duty of care to him ceases," the court added. During his testimony, the guest admitted that he never was given express permission to climb onto the roof, and the owner of the unit testified that she told the guest to get off the roof twice. "Nothing about the roof implied a recreational purpose or that anyone was supposed to be there except workmen," the trial court pointed out.

After the trial court found that the guest was a trespasser, it had to consider the appropriate standard of care required. The association could be liable to the guest, as a trespasser, only if it was guilty of "willful and wanton conduct." "Willful and wanton conduct involves not only intentional acts, but acts which exhibit a reckless disregard for the safety of others, such as a failure 'after knowledge of impending danger,' to exercise ordinary care," noted the trial court. "There is no evidence of any prior incidents involving the air shaft or of knowledge of impending danger on the part of the association," it said.

The guest challenged the trial court's determination that the association wasn't guilty of willful and wanton conduct. He argued that the trial court erred in finding no willful and wanton conduct where it failed to discover the "obvious danger" posed by the air shaft. The appeals court disagreed. It pointed out that, moreover, the guest's jumping over the fence onto the roof was not reasonably foreseeable to the association, and therefore, the association owed no duty toward him. ♦

- Keith Juzwicki v. Board of Managers, 1910-1912 Halsted Condominium Association, February 2013

Legal Compliance

(continued from p. 1)

Home Daycare Case in Point

That was the situation in a recent lawsuit where a federal district court denied an association's request to dismiss an FHA lawsuit filed by one of its two African-American members after the association ordered her to close her home business but allowed white members to continue to operate their businesses in the community. The court also found that two of the board members involved in the decision to close the business could also be held accountable for discrimination.

The association's governing documents allowed "invisible" in-home businesses to operate on an owner's premises. The member in this case ran a daycare business in her home without incident until neighbors noticed that one of her clients was Muslim. They subsequently verbally harassed the client and the member. Shortly thereafter, a complaint was filed against the member at a board meeting, but she wasn't notified of it.

The board then sent a letter to three home businesses including the member's. (Another of the businesses was also a daycare.) The letter requested information about the businesses. It was the first time that the member found out that a complaint had been made about her. The member offered to share her business records with the board and to work with it. She also sent a letter to her clients reminding them about showing courtesy when dropping off and picking up their children.

Nevertheless, the board sent her—but not the other businesses—a letter of noncompliance. She was directed by the board to close her business. The board later amended the governing documents to allow in-home businesses, subject to certain requirements. The wording of those specific requirements allowed for the stated activities of the other businesses, allowing them to operate, but not the member's particular daycare business.

The member's lawsuit in federal court was directed at the association as an organization and also the two board members acting in their individual capacity. Neither the association nor the board members could prove that they hadn't discriminated against the member [Fielder v. Sterling Park Homeowners Assn., December 2012].

Association's Motion to Dismiss Case Denied

To win her case, the member had to prove disparate treatment. The court concluded that she had alleged facts that showed this treatment. She showed that the board had asked her business, but no other home businesses, to close, even though it had operated continually without any complaints being raised for 12 years. The court took note of the fact that a complaint was raised after an African-American Muslim client began using the daycare.

The court also said that intentional discrimination could be inferred from the fact that neighbors harassed the member's clients, refused to discuss their complaints with her personally, and targeted her business alone while businesses run by white association members were allowed to function without interference. Because the court agreed that there was evidence of intentional discrimination against the member, it denied the association's request to dismiss the case.

Board Members Not Shielded from Liability

The board members claimed that their involvement in shutting down the member's business was protected by the "business judgment rule," a legal principle that makes officers, directors, managers, and other agents of a corporation immune from liability to the corporation for loss incurred in corporate transactions that are within their authority and power to make when sufficient evidence demonstrates that the transactions were made in good faith.

The court determined that the business judgment rule didn't apply here. Past fair housing rulings had determined that the business judgment rule "couldn't serve as an absolute defense against a charge of unlawful discrimination." The court agreed and concluded that the board member's motion to dismiss should be denied.

What can you do to protect your association and board of directors from a fair housing claim when enforcing home business rules? Communities can successfully defend against claims of disparate treatment with proof of a legitimate, nondiscriminatory reason for the policy or rule that's claimed to be unfair—and proof that it's applied consistently without regard to race or other protected characteristics.

EDITOR'S NOTE: For more information on setting and enforcing rules restricting members' home businesses, see "Controlling Owners' Business Use of Their Units," in the July 2011 *Insider,* and available at *www.CommunityAssociationInsider.com.* ♦