

# **THE IMPORTANCE OF ASSOCIATIONS – Knowing, Understanding, and Properly Enforcing Their Own Covenants**

Serving on a Homeowners' Association Board is a selfless commitment to community. It is, after all, a volunteer position, but it is also an important job. Association Boards enforce the community rules that range from assessment to architectural rules. Simply put, the consistent enforcement of various types of restrictive covenants is crucial to a healthy community.

The enforcement of restrictive covenants can significantly impact homeowners' lives. There is an inherent power in enforcing these restrictive covenants. Associations have the power to take legal action against homeowners whom the Association claims are not complying with certain restrictive covenants. Associations can issue fines and can collect on such fines through assessment liens and lawsuits. This power has to be balanced with the responsibility of properly enforcing the restrictive covenants. Such responsibility truly starts with Board Members knowing and understanding their own rules and policies.

If an Association does not understand its own rules and tries to enforce the rules despite any misunderstandings, there can be a very significant downside for the Association, and the homeowners as well, as discussed later in this article. To steal a line from Spider Man's uncle Ben, "Great power comes with great responsibility." While Board Members are volunteers, they do take on a role that involves a fiduciary duty to all homeowners of the community. With that role comes a definite responsibility for Board Members to understand and enforce the Association's various restrictive covenants consistently and in an even-handed way.

Fully understanding this responsibility will help all Board Members, prospective Board Members, and their managing agents ensure that they are doing all they can to properly enforce their community rules and to minimize legal pitfalls.

## THE RULES THAT CREATE RESTRICTIVE COVENANTS

Unfortunately, there is not just one easy set of rules for Board Members to follow. Various governing documents create the restrictive covenants that all homeowners must follow. Technically, there is a hierarchy of rules that an Association has to abide by, starting with the law at the federal, state, and local level. After the law, the Declaration, also often referred to as the Covenants, Conditions, and Restrictions ("CC&R"), is the primary governing document that provides the outline for the Association's authority and rules. After that, the By-laws provide additional mechanisms and details to assist the Board in enforcing the CC&R. At some point, after 2005, most Associations adopted additional rules and regulations dealing with specific issues such as reserves and meeting policies.

When you compile these rules, it can be overwhelming. The CC&R and other Association-governing documents can take up a large binder. Every homeowner should review these documents prior to purchasing a home in a covenant-controlled community, but the reality is that very few homeowners read them before a dispute arises. Despite the large number of rules, every Board member should start off service to their community by reviewing the Association's governing documents. If you are not familiar with your own rules, then it will be very difficult to enforce the rules and effectively lead your community. Further, not understanding your Association's rules can lead to the improper enforcement or the failure to enforce such rules.

## BOARD MEMBERS' RESPONSIBILITY FOR THE RULES

Board Members should be very familiar with their own rules. However, Board Members are not required to be **all-knowing** as regards the rules or the law. In fact, the law provides that Board Members are held to something known as the "Business Judgment Rule." Essentially, this legal principal is a reasonable-ness standard. The assumption is that Board Members make decisions on an informed basis, in good faith, and in the honest belief that an action is in the best interests of the Association. There is a legal presumption in Colorado that Board Members are acting in compliance with this legal standard. When Board Members' actions are called into question, the legal test is

whether or not a reasonable person on a Board would make the same decision under similar circumstances. In short, Board Members are given the benefit of the doubt, and they do not have to be perfect. Rather, they have to act reasonably and consistently.

Based on the Colorado Common Interest Ownership Act ("CCIOA"), our legislature has built in some other protections for HOA Board Members. For example, if a homeowner sues an Association, she can name any of the individual Board Members in the lawsuit, but proving liability against such individual Board Members is very difficult. It is easier to prove that the Association is liable for the various claims. This is because individual Board Members can only be liable for their actions if they have acted "willfully and wantonly." Willful and wanton conduct is behavior that is egregious and done with reckless disregard for homeowners' rights. This is very good news for Board Members because it is a very difficult legal standard to meet.

It is comforting to know that Associations are given a certain benefit of the doubt in how they conduct business and enforce their rules, and individual Board Members have a certain amount of protection from individual liability related to serving as a volunteer. However, as with all things in life, there is a bigger picture. Associations and their Board Members owe a definite duty to their communities to enforce their rules properly.

Colorado courts have found that all Colorado Homeowners' Associations have a fiduciary duty to homeowners to enforce restrictive covenants. This duty has been imposed in recognition of the power held by Homeowners' Associations, the quasi-governmental functions they serve, and the impact on value and enjoyment that can result from the failure to enforce covenants. Because of this fiduciary duty, all Associations have an obligation to enforce the CC&Rs, architectural rules, and/or other governing documents in good faith and in a reasonable manner. Again, Associations do not have to be perfect in executing their rules. They are entitled to make some mistakes. However, the law requires Associations and their Board Members to act reasonably. If they do not, they risk breaching their fiduciary duty.

This fiduciary duty means three really important things.

1. Board Members need to fully understand their Association's rules;

2. A Board cannot make up its own rules as it goes along without first amending its existing written rules. It must rely upon the rules in place and rely upon reasonable interpretation of those rules; and
3. An Association must evenhandedly enforce the existing rules.

If an Association is not evenhanded in enforcing these restrictive covenants, it can be accused of selective enforcement.

## **THE PERILS OF SELECTIVE ENFORCEMENT**

Selective enforcement can be equated to a breach of an Association's fiduciary duty to its homeowners. Selective enforcement is the enforcement of a particular restrictive covenant against one homeowner and not against another. Selective enforcement can be grounds for a homeowner to claim that the Association has breached its own restrictive covenants and/or its fiduciary duty. In some instances, selective enforcement could also be grounds for a discrimination claim under fair housing or other civil rights laws if there is evidence that an Association has treated one homeowner better than another and the homeowner treated less favorably is in a protected class different from the homeowner who was treated more favorably.

Based on Colorado case law and similar case law from other parts of the country, an Association is only liable for selective enforcement if it is enforcing a specific covenant unequally. It is not selective enforcement if there are some inconsistencies in enforcement related to different covenants. For instance, your Association issues a fine to a homeowner who has repeatedly refused to pull weeds from his front yard. The homeowner then claims that the fine is selective enforcement because his neighbor has a R.V. parked in his back yard, which is visible above the fence line, and he knows for a fact it is a covenant violation and that the owner with the R.V. has not received a fine. While the homeowner with the R.V. may be violating a restrictive covenant, the homeowner with the fine for not pulling weeds cannot claim selective enforcement because he is complaining about a different covenant. Selective enforcement involves inconsistencies in the way in which an Association enforces the same covenants. If the

Association fined homeowner A for not pulling weeds but did not fine Homeowner B for the same issue, then there is a possible argument for selective enforcement.

## **REAL WORLD EXAMPLES OF PROBLEMS WITH RULE ENFORCEMENT**

The following scenarios are based on real life examples from cases we have dealt with. They are provided to illustrate the importance of understanding the rules and enforcing them properly.

### *The Problem of the Rule That Has Not Been Enforced*

Holly Homeowner lives in property that is in the Happy Acres Association, which is a condominium community. Holly's heat is not working properly. Holly knows that Ben upstairs had a similar issue last year and that the Association took care of it. Holly contacts her Association's property manager, who took over the management last month, and Holly complains about the heat to him. The property manager, after talking with the Association's attorney, realizes there is trouble brewing in Happy Acres because the heat is the homeowner's responsibility and not the Association's. Pursuant to Happy Acres' CC&R, it is crystal clear that homeowners are responsible for the maintenance and repair of everything in their individual "air space" and that heating falls under that covenant.

The Association now faces a fairly puzzling problem. On one hand, the CC&R is clear as to whose responsibility this is. On the other hand, the Association paid for repairs for Ben. In short, Happy Acres did not follow its own rules with Ben. Holly wants the same treatment from the Board that Ben received. In fact, if the Board enforces the covenant, as written, against her, she will demand that the Board make Ben pay back the money for the repairs that Happy Acres paid for. The question now becomes whether the Association should immediately enforce its covenant, as written, or waive it as to Holly.

The consequence of not enforcing a specific rule is the possibility that a court could conclude that the Association has abandoned the rule. Thus, it is critical for Board Members and their managing agents to know the rules so that the rules can be

enforced to begin with and enforced evenhandedly. If there have been some variances, it is important to resume the proper enforcement of the covenant and treat all homeowners equally.

In the above example, if Ben is the only exception, Happy Acres is fairly safe saying that they made a mistake, but they are not waiving the covenant at issue. Happy Acres inadvertently waived the provision as to Ben, so it cannot now demand that he pay the money back that they paid for the heat repair. However, Happy Acres can explain to Holly that their prior deal with Ben was a mistake and that they did not plan to waive the covenant and that, as a result, they have to enforce it as to her. If it turns out the Association paid for heating repairs for various homeowners besides Ben, then Holly could argue the covenant has been abandoned.

What if Holly claims discrimination? Holly could claim that the Association is committing gender discrimination by treating Ben more favorably than she. Or, what if Holly is Asian and Ben is not Asian, and she claims race discrimination? The Association can probably defeat the allegation of race on the basis that it has a legitimate nondiscriminatory reason for treating Holly differently than Ben, based on the fact that if they do not now enforce this covenant, the Association could be setting a precedent that the covenant is abandoned. Nevertheless, this scenario shows the type of issues that can result from not enforcing or neglecting a rule.

### ***The Problem of the Unwritten But Enforced Rule***

We have also seen examples of how an Association enforces a rule that is not necessarily specifically provided for in the governing documents. The following scenario illustrates this dilemma.

Harry Homeowner wants to install a fence around his yard. He reads his CC&R and architectural rules carefully. He learns that his fence must be a split-rail fence constructed only of wood and must be no taller than 3 feet. There is no requirement that he obtain prior approval from the Association. Rather, the requirement is to comply with the type of material and height restriction upon installation.

A couple of months after Harry installs his fence, he gets a letter from his Association's management company, stating that his fence does not comply with the Association's rules because it does not match the color of the house. The letter states he must match the color of his house or the Association will fine him. Harry writes the management company and states that there is nothing that he sees in the governing documents that states the fence has to match the color of his house and that his fence complies with the relevant covenant.

Harry's Association takes the position that its architectural board feels that fences should match the color of homes in the community for aesthetic reasons. The Association's Board feels they can support this by showing that they have issued other homeowners fines for the same exact issue.

Can the Association fine Harry on the rule that the fence must match the color of the house, given that they have enforced this rule against other homeowners? The answer is that the Association cannot unless there is some other covenant that more than justifies an interpretation that fences must match the color of the house. If there is no such covenant language, an Association cannot make up a rule that is not in the covenants and enforce it. Worse, if the Association does, and a homeowner like Harry can prove that the Association has selectively enforced the non-existent rule, there can be a claim for selective enforcement.

These are examples of situations that are obviously problematic for Associations and their Board Members. These situations also show the level of responsibility an Association has for its own rules. A Board Member's role is a two-sided coin. On one side, a Board Member does not have to be perfect. The Business Judgment Rule provides that protection. On the other side of the coin, a Board Member absolutely has to know the rules the Association enforces and has to be a part of a process that ensures even-handed enforcement.

Following some practical guidelines on a consistent basis can provide a lot of protection against straying from the rules and from improperly enforcing the rules.

## PRACTICAL GUIDELINES TO FOLLOW

We recommend that Board Members strive to follow these guidelines.

1. Review and periodically re-review the governing documents. Periodic review keeps Board Members refreshed on the rules.
2. New Board Members should be given packets on information with which they are required to be familiar.
3. The key, however, is for all Board Members and managing agents to stay familiar with the rules.
4. Before policies are adopted, Board Members and managing agents should revisit the rules.

We recommend not enforcing rules that are not clearly established in the governing documents. As shown in the example above, this is problematic and it can be hard to show that there is language in other governing documents that supports the Board's interpretation.

Foster an environment of consistency and fairness. Board Members and their managing agents should mandate consistency. Consistency requires documentation. Proper documentation requires the proper mechanisms to track information. For example, many Associations have enforcement logs in which they document how they enforce particular covenants. Many management companies have software to track the same information.

Part of being consistent is allowing dialogue with a homeowner who has a dispute over an alleged covenant violation. While Board meetings need to be structured to limit homeowners who want to go on and on about their issues, Board Members must address disputes about how covenants are being handled, and then they must document those discussions in the meeting minutes.

Active listening by the Association can lead to resolutions outside of the courtroom. Remember, most of the time, the only people who win in court are the lawyers.

The best way to demonstrate that a Board has been fair and consistent is to document how the Board responded to the homeowner and how the Association has treated other homeowners equally.

If there are reasons why an Association has treated certain homeowners differently than other homeowners, documentation is critical to show the motivation. If there is a valid business reason, the Association must have documentation that backs up the reason.

Create and follow an enforcement policy. All Associations are required to have a policy that deals with enforcement of covenants. This was required in the SB-100 bill that was passed in 2005. *If your Association does not have an enforcement policy, it needs to get one immediately.*

In creating an enforcement policy, great thought needs to be given to the policy itself and how to administer it. Creating the policy will govern how the Association will enforce and how it will track such enforcement. Once the policy is in place, it is that much easier for an Association to be fair and consistent, as discussed above.

Knowing the rules and having the right policies to enforce the rules cannot guarantee that an Association will never have a legal dispute over the rules, but it goes a long way in helping the Association demonstrate that it has acted accordingly. Further, knowing the rules and enforcing them properly leads to a healthy community.