COMMUNITY MATTERS

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News and Trends in Community Association Law

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Keeping it Legal: Bankruptcy & Post-Petition Arrears – What Can Be Done...the Legal Way

by Daniel E. Melchi, Esq.

The number one problem that is brought to our firm's attention from our community association clients has to do with homeowners who are in bankruptcy, but they are not paying their post-petition association assessments. This is a very common problem, and, depending upon which type of community association exists, the remedies are different.

When a homeowner files for bankruptcy, he or she files a "petition" for bankruptcy. Everything owed prior to the petition date and on the petition date is referred to as "pre-petition", and everything owed after the petition date is referred to as "post-petition." Pre-petition amounts are shielded from collection while the bankruptcy case is ongoing. These amounts are generally paid through the bankruptcy case if the debtor wants to keep his or her property (such as in a Chapter 13 repayment plan case) or these amounts are discharged and may not be collected personally from the debtor once a bankruptcy discharge is entered. Post-petition amounts, on the other hand, are not generally shielded from some types of collection activity, and the debtor is liable for these amounts that are owed to a community association. The problem arises with how to collect these post-petition amounts from the debtor.

A very common question we often receive from property managers and community association directors is, "The debtor is not paying their post-petition assessments. Aren't they required to pay their post-petition amounts?" The short answer is, "Yes, they are required to do so." But it is not that simple. People are required to do all sorts of things in everyday life, but as we all know, a requirement can be ignored. (We are required to follow the speed limit; but if we do not, we only get in trouble if we get caught and some kind of action is taken, such as getting a ticket.) When a debtor violates the requirement to pay post-petition community association fees, it is up to the association creditor to seek redress through the Bankruptcy Court in order to enforce this requirement.

Condominiums & Property Owners' Association Act-Submitted Associations ("COA/POA")

When a debtor is not paying post-petition assessments to a COA or POA, the main remedy (in the bankruptcy context) is that the COA/POA may file a "Motion for Relief from Stay" ("MFR") in the Bankruptcy Court. An MFR is a contested matter that advances several key points, namely (1) that the debtor is failing to pay post-petition assessments and (2) that legal "cause" exists for the Bankruptcy Court to "lift" the automatic bankruptcy stay currently shielding the debtor from collection.

The sole reason that a Bankruptcy Court lifts the bankruptcy stay will be to allow the COA/POA to exercise foreclosure rights in the state court system by initiating (or continuing a currently-stayed) judicial foreclosure action to foreclose the COA/POA lien. It is important to note that judicial foreclosure is generally the only thing that a Bankruptcy Court will allow a COA/POA to do. The Bankruptcy Court is not going to lift the bankruptcy stay to allow a COA/POA to file a lawsuit, get a judgment, and then collect upon that judgment by filing garnishments. Doing so would make the debtor's entire bankruptcy case fall apart. If a debtor is in a three- to five-year Chapter 13 payment plan, one creditor coming in and garnishing the debtor's wages is going to upend the entire bankruptcy case, preventing all of the other identified creditors from being paid. The Bankruptcy Court will simply not let this occur, regardless of whether or not the COA/POA thinks that it is fair.

So filing an MFR is the only real option for a COA/POA. There are a few drawbacks to filing an MFR, with the first being the cost associated with it. Just filing an MFR automatically comes with a $181 filing fee that is paid to the Clerk of the Court. In addition to this hard cost paid to the Clerk, one must factor in the attorney time involved in filing the MFR and attending the required hearing. MFRs, when all is said and done, can cost upwards of $800 just to obtain. A second drawback to an MFR is that if an MFR is granted, the pre-petition claim (usually in the form of a filed Proof of Claim and being paid out in the Chapter 13 Plan) will immediately cease being funded by the Chapter 13 Trustee. The Bankruptcy Court's rationale behind this is that if a creditor is seeking to foreclose a lien on the property, the creditor should have its claim satisfied outside of bankruptcy in the foreclosure. The remainder of the creditors in the debtor's bankruptcy case should not continue to receive less on their claims while the stay-lifted creditor continues being paid on its claim in the bankruptcy case and have its claim satisfied outside of bankruptcy.

Although there are a few drawbacks, there are also benefits to filing an MFR. In the vast majority of cases, just the filing of an MFR will get the debtor's attention. The debtor is usually in bankruptcy in the first place because the debtor wants to retain the debtor's home and not lose it to foreclosure. Most MFRs are settled with a "Consent Order Conditionally Denying the Motion for

Relief from Stay." The debtor or debtor's attorney usually reaches out to the creditor's attorney and says, "Hey, the debtor really does not want to lose the home. Can we work something out?" Usually, the Bankruptcy Court will agree to conditionally deny an MFR so long as the Debtor does X, Y, and Z (usually repay the arrears relatively quickly and agree to make future assessment payments on time as they come due). If the debtor fails to abide by this Consent Order, then the creditor simply submits a notice of default to the Bankruptcy Court, and the MFR is granted without any further court hearings. Once an MFR is granted, either initially or by defaulting on a Consent Order, the bankruptcy stay is lifted, the COA/POA may proceed with the foreclosure process in the state court system, divest the debtor of ownership of the property, and hopefully get someone in the home who is more reliable in the payment of future assessments.

Common Law HOAs

Non-payment of post-petition arrears to common law HOAs are a tougher situation. Common law HOAs are generally required to first pay off superior liens and mortgages before they are permitted to foreclose upon their HOA liens. (This is not the case with COAs/POAs.) This is usually not feasible for most HOAs, so the filing of an MFR when the creditor is a common law HOA is not beneficial. This is because, as stated earlier, the Bankruptcy Court is not going to allow the bankruptcy stay to be lifted to allow for garnishments or other activity that is going to turn the entire bankruptcy case on its head, causing the whole case to collapse.

The first option, and perhaps the most recommended, is to wait. More specifically, the common law HOA would monitor the bankruptcy until there are about six months left on the bankruptcy case (or sooner if the four-year statute of limitations is going to expire on any post-petition assessments). At that time, the common law HOA would file a lawsuit against the debtor in the state court system to obtain a judgment for the post-petition assessment arrearage. The act of obtaining a judgment for post-petition assessments is not a stay violation; however, the collecting upon that judgment is a stay violation.

So, when the bankruptcy case is almost over, an HOA can obtain a judgment and just wait a few months until the bankruptcy case has officially ended. Once it has ended, then the HOA can take its relatively-fresh judgment and begin collection efforts on it normally, such as filing garnishments. The reason we suggest waiting until near the end of a bankruptcy case is because it is better to have a fresh judgment encompassing several years of assessments rather than filing such a lawsuit in Year Two of a five-year Chapter 13 case, and then having a stale judgment without Years Three, Four, and Five encompassed in that judgment, too.

The second option for a common law HOA is to file a Motion to Dismiss Case ("MTD"). The rationale is that the debtor has budgeted for post-petition HOA assessments, is withholding this amount from the Trustee (and the other creditors) each month, and is clearly not using this money for its intended purpose. The Bankruptcy Court considers filing an MTD to be a drastic measure, and most Bankruptcy Judges are reluctant to dismiss an entire bankruptcy case when the debt owed to the HOA is not dischargeable and the HOA can seek its remedy once the case is over. This is not something HOAs would think is fair, but from the Bankruptcy Court's perspective, many other creditors are being paid through the bankruptcy case, and dismissing an entire case due to one creditor is not in the best interests of all of the other creditors.

Community associations not being paid what they are owed, post-petition, by debtors in bankruptcy is endemic. In fact, it is probably more often the case than not. The limited remedies that community associations have, however, should be carefully considered before undertaking them. Such associations should consult their attorney to figure out the best and most cost-effective course of action to pursue that will yield the result the community association is hoping to achieve.

Enjoying Your Summer Pool Season in Peace and Quiet

by | **Elina V. Brim, Esq.**

The sun is out, people are enjoying the great outdoors, and the pool season is in full swing. But with the pool season comes a new set of complaints from homeowners. One recurring complaint seems to be what the board can or should do about "those rowdy kids in the pool." Where are the parents? Shouldn't these minors be supervised? These complaints give rise to a very important yet frequently overlooked legal issue: pool rules which may run afoul of a federal law called the Fair Housing Act (the "FHA").

The FHA makes it unlawful to discriminate against any person in the provision of services or facilities in connection with ownership of property because of a person's familial status. 'Familial status' means one or more individuals (who have not attained the age of 18 years) living with a parent or another person having legal custody of such individual or individuals. In plain terms, the FHA prohibits discrimination against families with children. A violation of the FHA can be established by showing the existence of a facially discriminatory rule treating children, and thus, families with children, differently and less favorably than adults-only households. Some of the rules that the courts have found to be facially discriminatory are rules requiring adult supervision of any person under 18 at the pool, rules prohibiting children from using certain portions of the pool area, and rules requiring children to leave the pool so individuals over 18 can have "adult swim time." These rules plainly treat children and adults differently, and thus, are discriminatory on their face.

If the board of directors creates a facially discriminatory rule that treats individuals differently based on age, it has to be able to justify the rule by providing a legitimate non-discriminatory reason for the rule. What constitutes a "legitimate, non-discriminatory reason" is not settled law in our federal judicial Circuit. However, some District Courts and neighboring federal Circuits have held that a legitimate non-discriminatory reason can be established by showing that the facially discriminatory rule either benefits the protected class (in this case, minor children) or addresses a legitimate safety concern raised by the individuals affected. Even when a legitimate non-discriminatory reason is articulated, any person affected adversely by the rule can argue that the official reason for the rule is just a disguised way to allow unauthorized discrimination. Further, while many rules can be justified as addressing safety concerns, the courts have generally stated that it is up to the fact finder to determine whether the articulated justification is valid.

Boards should be aware that the FHA may punish well-intentioned rules. To steer clear of legal issues and the uncertainties of legal disputes, it is important to draft rules that do not differentiate on the basis of age. The first step is to identify the conduct that the Board wants to prohibit. The second step is to narrowly draft a rule to address such conduct. For instance, if the Board wants to prohibit running and yelling in the pool, the rule should state "No running or yelling in the common areas." The rule addresses the conduct that is objectionable, and its phrasing complies with the FHA. Avoid rules that connect objectionable conduct to children, such as "Children should not run or yell in the common areas."

In some cases, community rules that require supervision of minors are appropriate, depending the nature of regulated conduct; however, caution should be exercised in creating such rules. If you need further assistance with drafting pool rules or if you feel your association could benefit from a thorough review of the association's existing pool rules, please contact your association's general attorney.

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