



November 2013

Forgiving Debt, Part II: When You Can Forgive Owners' Debt

Variations on the Rule

In many states, you're prohibited from forgiving owners from paying properly passed assessments, either by state law or because such an agreement would be a breach of your fiduciary duties. But you can forgive other types of debt or all debt as part of larger settlement.

"With today's collections crisis, we have debt that includes interest, late fees, and attorneys' fees," says Jed L. Frankel, a partner at Eisinger, Brown, Lewis, Frankel & Chalet PA in Hollywood, Fla., who advises community associations. "So when we have a unit owner who's gotten behind and has come to us to work out some sort of arrangement, the easiest thing to do is to forgive some of the interest, late fees, and attorneys' fees. But even if the board forgives all of that, you still have the underlying assessments, and I can't think of a situation where we've had a client reduce the amount of those underlying assessments where there's no question it's been owed.

"I won't say never," adds Frankel. "There could be a situation where a board, exercising its business judgment, says, 'OK, we're willing to do that.'"

Frankel works through a potential example off the cuff but then rejects it: "I'll go out on a limb," he explains. "The presumption is that these assessments have been legally assessed and they're valid. But maybe there's litigation over whether an assessment was validly passed. When we begin collection proceedings, I have a lot of people argue, 'These assessments weren't valid! Why? Because I don't like that you use them for the swimming pool because I never use it.' But that doesn't make the assessments invalid.

"What might make assessments invalid might be that the annual budget meeting where they were passed wasn't noticed properly," explains Frankel. "But even then, all we're going to do is notice the meeting correctly and pass the assessments again. Because otherwise we're faced with a situation in which all the assessments after then are invalid, and this person is correct and we settle, that invalidity would apply to everyone in the community. So I can't come up with a scenario where one person should be treated differently than everybody else with regard to underlying assessments."

Nathaniel Abbate Jr. also separates assessments from other costs. "We look at late fees and interest as soft costs," says Abbate, a partner at Makower Abbate & Associates PLLC in Farmington Hills, Mich., who represents associations. "It's not like the HOA is penny-for-penny out of pocket on those. If we file a lawsuit, the Michigan condo act says we 'shall' recover attorneys' fees if we win, so it's a lot easier to stick to your guns on those. But when it comes to late fees, interest, and costs like that, the association isn't out of pocket for those things necessarily."

Abbate has also seen associations settle their right to collect unpaid assessments when it's in the association's longer-term interest because the association isn't without fault. "Where I've seen it, and

it's been rare, is in cases where the board exercises the discretion it enjoys under the **best business judgment rule**," says Abbate. "The board might say, 'Yes this person owes X amount in unpaid assessments. But she's also making noise about suing the board to compel it to make repairs or complaining that some things have been done in a discriminatory fashion.'

"For example, maybe we've filed a bylaw violation for, say, parking commercial vehicles improperly, and it turns out one of the board members has a snow plow that sits in his driveway unchallenged," explains Abbate. "When we hear about selective enforcement, we try to counsel boards they shouldn't do that, especially since it may impact our case in court. So we may include unpaid assessments in that settlement negotiation if there's a reason like that, where we may not have been told all the cards we're playing with. For settlement purposes, we say, 'Board, you may have to eat some attorneys' fees or unpaid assessments.' It might be that technically, the association is owed \$800, but it'll settle for \$600 because that'll net the association more than if it stuck to its guns and pursued the case in court.

"There are myriad considerations a board can take into account," concludes Abbate. "As long as you can justify your action through the business decision rule, you're OK. But you also better be able to explain it to an angry mob of other owners who might hear about it."