COMMUNITY MATTERS

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Bankruptcy and Accounting: Best Practices and Tips

by | **Daniel E. Melchi, Esq.**

Directors and managers often ask me, "What do I do with a homeowner's account when he or she files for bankruptcy?" It's a good question, and there are several different things to take into consideration when deciding how to move forward from an accounting perspective.

All homeowners should have an account with the association. This account shows the running history of assessments, late fees, interest, fines, payments, waivers, and other charges or credits. Let's call this the homeowner's "Main Account."

When a homeowner files a petition for bankruptcy, all amounts owed as of the petition date and backwards are considered "pre-petition," and all amounts that will come due from the day after the petition date and forward will be considered "post-petition."

I have found that the following accounting practice best conveys the most accurate information about the ongoing amounts owed by a homeowner in bankruptcy, facilitates the orderly acceptance of payments without interruption and confusion, and reduces the need for future account reconciliation and adjustments. As soon as the association or its agent learns that a homeowner has filed for bankruptcy, you should:

1. Leave the Main Account alone (for now), and during the bankruptcy case, you will now consider this the "post-petition account." (Don't worry: We will be moving amounts out of this account because of the bankruptcy shortly. Read on!) There is no need to re-name it or otherwise change its account number or other identifying information. There is no need to turn the Main Account off or restrict homeowner access to it. In fact, if such access restriction has been put into place on this account (due to it being with a law firm for collection, for example), please reactivate the homeowner's ability to access this account and treat it just like any other non-bankrupt homeowner (i.e., send bills to the homeowner from it, accept homeowner payments made to it, etc.).

2. Create a new account within the association's accounting software. For those homeowners who have filed for bankruptcy more than once, use the previously-created account you used in the last bankruptcy case for this step. For account creation purposes, pretend that a new lot has been added to the community. Do what you would normally do in this situation by creating a new account, only this account will be special: this will be the "pre-petition account." When you create this account, you are going to do certain things with its settings, if your accounting software allows, namely: (1) "Flag" the account or restrict the homeowner from accessing or making payments to this account. (2) Turn off interest calculation on this account. (Interest is generally not allowed to accrue on pre-petition balances in bankruptcy.)

3. Go back to the Main Account (now known as the "post-petition account"), and draw a line (physically or in your imagination) across the account on the bankruptcy petition filing date. The amount shown above the line is pre-petition, and the amount shown below the line is post-petition. Take the whole pre-petition amount, and enter some kind of "credit" or "adjust-down" for that entire amount, and enter it on the Main Account (post-petition account) so that amounts now showing on that account only start accruing on the day after the bankruptcy filing date and forward. (If you did this step immediately following the bankruptcy filing date, the account will likely now say "$0.00" until the next, post-petition assessment comes due. If you only got notice of the bankruptcy filing months after the filing date, only whole amounts that fell due after the bankruptcy filing date will be now be left on this account.)

Remember: There is no "pro-rating" in bankruptcy. If a whole amount fell due prior to a bankruptcy petition date, then that whole amount is pre-petition. Similarly, of a homeowner filed for bankruptcy on the tenth day of the month, and late fees are assessed on the eleventh day of each month, there can be no late fee assessed for that month (because the homeowner filed for bankruptcy before the late charge date, and, technically, that assessment was not "late").

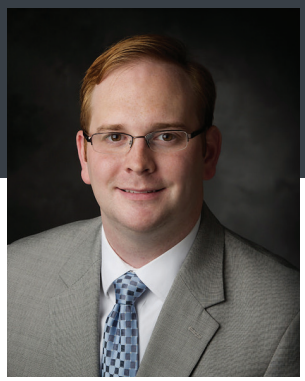
4. Go back to the newly-created "pre-petition account." Take the amount that you credited in Step 3 (above) and enter it as a whole charge on this account. That is the pre-petition amount owed.

5. If a bankruptcy case is dismissed, just enter a "credit"/"adjust-down" on the pre-petition account for the remaining balance in that account, take that amount, and do a "charge" entry on the Main Account/post-petition account. Now the Main Account is back to its pre-bankruptcy status. If your accounting software can "merge" the amount from the pre-petition account back onto the Main Account, this is even better. That way, you can apply interest as if the bankruptcy had never taken place since debtors lose their benefit of having no interest accruing on pre-petition amounts when their bankruptcy cases are dismissed.

Once you have made these adjustments, then you will be fully prepared for what comes next: new assessments, Trustee payments, homeowner payments, and, of course, bankruptcy dismissals and re-filings.

Each association may choose to proceed with its own accounting practices when a homeowner files for bankruptcy, but in my experience, the steps laid out above ensure the best results, reduce costs, and eliminate most accounting mistakes.

Judgment Obtained – Now What?



by | **Harrison J. Woodworth, Esq.**

I have very good news for you: your association just obtained a judgment against a delinquent homeowner. This judgment has long been sought after, and your association

I have very good news for you: your association just obtained a judgment against a delinquent homeowner. This judgment has long been sought after, and your association incurred expense through a contentious process in order to obtain it. But now you have it: a legal order entitling your association to relief of those expenses and unpaid amounts owed to the association. So on to the next question: What exactly do we do with it?

The options on how to proceed vary based upon the relief contained in the judgment. The most common is an award for money damages, typically in the form of principal assessments, interest, and collection fees and costs. A judgment for money damages will allow the association to file a garnishment against the delinquent owner to attempt to obtain assets to satisfy the judgment. The judgment also allows the association to place a judicial lien on the property, through a writ of *fieri facias*. If the association is submitted to the Condo Act or the Property Owners' Association Act ("POA"), the judgment may also include an order allowing the association to foreclose upon its lien on the subject property. These are not mutually exclusive, and lawsuits can and often do seek multiple forms of relief. In fact, we address the cases that may include a demand for unpaid assessments, as well as collection of fines or seeking to cure a covenant violation further below.

Georgia law requires that the holder of a judgment cannot take any action to enforce a judgment for a period of ten days after the judgment, with the exception of judgments entered by default. While there may be a waiting period that applies for most judgments, the association can still begin the process of searching for potential collectable assets. Up until the entry of a judgment, with few exceptions, funds paid toward delinquent accounts will come through voluntary payments by the owner. The garnishment process is when the "involuntary" payments begin. Garnishments are most commonly filed against an owner's bank or an owner's employer, but anyone who holds money for or pays money to a defendant is a potential garnishee. For example, a tenant who owes the owner rent payments can become a garnishee who is required in a garnishment action to pay that money to the judgment holder. The association's board's "local knowledge" can be crucial: Does anyone on the board know the owner personally and know where the owner works, or, if the owner has made any recent payments via check, what bank are the funds being drawn from? The association's attorney will be able to skip-trace for assets as well, but collaboration among all involves often helps bring in satisfactory results and make the collection process much less expensive for the association.

Now, what about those cases where the association is seeking money damages AND wants the owner to comply with the covenants and cure a covenant violation? We typically call these covenant enforcement cases. In cases where there is an ongoing violation on the property, the court in its judgment would likely include an order instructing the owner to cure some defect on the property, typically within a set time frame. If the owner fails to do so within that time frame, the association may move the court to compel the action and, if that fails, move the court to find the owner in contempt of court. This can result in serious additional sanctions to the owner such as fines or incarceration in the county jail until the owner complies with the order. The Association may have power under the judgment to go onto the property and fix the issue(s) itself and then assess the costs of doing so to the defendant in a process known as "self-help." The latter is often a faster and more efficient way of resolving issues on the property, but is not always a feasible option.

If the judgment included an order allowing the association to foreclose upon its lien on the subject property, the association's attorney can work with the county sheriff to levy upon the property and schedule a foreclosure sale. This is typically the remedy of last resort, and often is employed when there are few, if any, other options left. If the owner has been a long-term nuisance to the community, whether that is due to continued failure to pay assessments or repeated covenant violations (or both), the board may decide the best case scenario is to get the problem owner out and, hopefully, end the headache for good. A foreclosure sale is often also advisable when prior attempts to collect on the judgment have been unsuccessful, or as a practical matter, the board believes there are few collectable assets. The owner still has time to negotiate a settlement while the sale is pending, and often the scheduling of the sale compels the owner to try to make amends.

A judgment itself is just a piece of paper; but with the right legal enforcement, it can be a powerful tool for an association to collect what it is owed or correct covenant violations.

Before a Lawsuit is Filed, Make Sure You Check for ADR Requirements in Your Covenants

by | **Haley H. Bourret, Esq.**

Do the governing documents for your community have requirements that must be satisfied before the association can file a lawsuit?

If so, it is important to be familiar with and follow the requirements since noncompliance can have a substantial impact on the association's likelihood of success in a lawsuit.

Covenants on real estate are specialized contracts for the benefit of all property owners. Mandatory alternative dispute resolution ("ADR") provisions will often require parties to a contract to attempt to resolve their dispute through mediation or other non-litigatory means before either party can file a lawsuit against the other. In the context of community associations, an association may be required to send written notice to a member and afford them the right to a hearing before the Board of Directors before the association can file an action against the member. In cases involving mandatory ADR requirements, Georgia courts have held that, where a contract requires mandatory ADR, such provisions must be met before either party can sue the other.

Ideally, an association's Board of Directors will be aware of any ADR requirements in the governing documents and will comply with them prior to initiating litigation. In reality, lawsuits are sometimes filed before ADR requirements are met. If an opposing party raises the noncompliance with the ADR requirements as a defense, the progression of the case depends largely upon the decision of the court.

For example, in the case of *Houseboat Store v. Chris-Craft*, the Georgia Court of Appeals held that a trial court may dismiss a plaintiff's claims where a plaintiff fails to allege in its complaint that it complied with a mandatory mediation provision prior to filing its lawsuit, though, in some cases, the plaintiff may be permitted to re-file after it meets the conditions.

On the other hand, a court may determine that simply suspending the case temporarily and allowing the parties an opportunity to comply with the ADR requirements is more appropriate. In the case of *Mobility Transit Services vs. Augusta* in the United States District Court for the Southern District of Georgia, the court found that a party's failure to submit its dispute to mediation did not strip the court of jurisdiction or warrant dismissal of the party's complaint, and it found that a stay of the proceedings was more appropriate than outright dismissal.

Sometimes, a party may waive its defense by failing to raise the opposing party's noncompliance with a mandatory ADR requirement. For example, in the case of *Gray v. Province-Grace*, the United States District Court for the Northern District of Georgia found that the defendant waived its right to assert the plaintiff's failure to comply with a mandatory mediation requirement where the defendant's actions were "inconsistent with a desire to pursue alternative dispute resolution." In that case, the defendant answered the plaintiff's complaint, filed a counterclaim, and served discovery, but the defendant did not raise alternative dispute resolution until well into the case. Due to defendant's actions, the court found that the defendant waived its right to the alternative dispute resolution procedure in the contract at issue.

From the cases above, outcomes can widely differ. Courts could find dismissal of a case warranted. Other times, the case could be stayed, or "suspended", in order for the parties to satisfy the ADR requirements. And, depending on when the defense is raised in the case by the defendant, waiver of the ADR requirement may be upheld by the court.

Failure to comply with a mandatory alternative dispute resolution requirement in the governing documents can have a significant impact on the association's likelihood of success in a dispute. To avoid this, a Board of Directors should determine whether such requirements exist, and, if so, ensure that the association complies with the requirement prior to instituting litigation.

LUEDER, LARKIN & HUNTER

t: 770.685.7000 f: 770.685.7002

www.luederlaw.com | email: newsletter@luederlaw.com