

# COMMUNITY FOCUS OREGON

*The Northwest's Full Service HOA Law Firm and Resource Center*

## Are We Making the Right Decision?

### Fiduciary Duties and the Business Judgment Rule

Board members of homeowners associations are frequently faced with decisions that have significant impact on the owners within the association. Should the board require an owner to remove a fence that was installed without permission? Should the board hire the treasurer's brother to paint the condominium? Should the board increase monthly dues to meet a budget shortfall? These are some of the questions boards often face and with which they struggle.



Members of a board of directors owe "fiduciary duties" to the association. Put simply, this means that board members must always act in the best interest of the association and not in the interest of individual owners or board members. Further, a board member must avoid all con-

flicts of interest and self-dealing. The law imposes this higher standard of care on board members because entire communities depend on board members to operate and maintain the association. This means enforcing the provisions of the governing documents, maintaining property for which the association is responsible, and purchasing adequate insurance.

Decisions by a board are judged on a related legal principle: the business judgment rule. This rule says that if a board member makes a decision after researching and understanding the significance and consequences of the decision, generally the board member will be protected from liability even if the decision turned out to be a bad one.

The rule requires that board members diligently investigate facts and circumstances prior to making decisions, act in good faith, and discharge their duties with reasonable care. Lastly, the rule requires board members to exercise supervision over individuals or entities to whom authority is delegated.

With the preceding principles in mind, there are several things individual board members can do to protect themselves from personal liability. Examples include: (1) Attend and participate in all board meetings (remember, board members cannot give proxies!), (2) avoid conflicts of interest, (3) become familiar with the provisions in the Declaration, Bylaws, and rules and regulations, and (4) stay informed of all association business.

Although it is impossible to completely eliminate personal liability when acting as a board member, adhering to the general principles of the business judgment rule and properly exercising fiduciary duties will help to ensure that board members are not exposed to personal liability while acting in their capacity as board members. And remember, the business judgment rule is never a substitute for adequate directors and officers insurance!

~Kevin V. Harker~

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### SPECIAL POINTS OF INTEREST:

This issue contains a "Quick Guide to Parliamentary Procedure," a special tear-out guide referencing Robert's Rules of Order.

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## Dank Whetley Addresses Smoking

Dear Dank,

*We're a condo complex of 56 units. We have many unhappy owners who are complaining about neighbors who smoke. The smoke enters into the units through normal cracks and crevices but mainly through windows and patio doors while open. These owners cannot open their windows and doors to get fresh air and they're also concerned about second hand smoke. This is a very sensitive subject. Can the HOA enforce a no-smoking rule? If yes, to what extent?*

*Please advise. Thanks!*

Chairperson

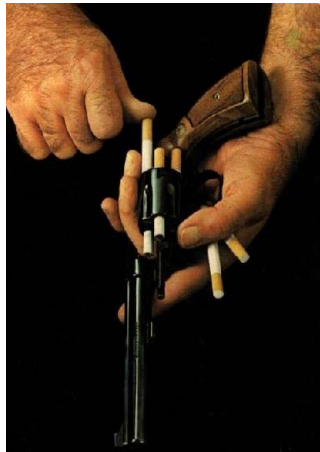
*Up in Smoke Condominium*

Dear Chairperson:

This is a question I get fairly often. It involves two very fundamental rights: the right to do whatever you want which is legal within your home (such as smoking), and the right to quiet enjoyment of your property, free from nuisance. Oregon law defines a nuisance as the invasion of person's interest in the reasonable use and enjoyment of his land.



Oregon courts have not yet addressed whether tobacco smoke is a nuisance, but they have held other kinds of smoke and noxious odors to be a nuisance in several cases.\* When discussing smoke and odors, the courts have held the activity is a nuisance if it is inherently harmful, and cre-



ates an unreasonable and substantial interference with the ordinary use or enjoyment of property. Applying that reasoning here, there is no question society considers secondhand smoke to be inherently harmful. The only issue is whether the level of smoke infiltration into other units constitutes unreasonable and substantial interference. If so, nearly all governing documents have provisions which enable the Board to abate any "nuisance" or "interference with peaceful enjoyment of property." The Board then has the authority to act if the infiltration is bad enough.

Indeed, the Board may have no choice but to act. Associations have not yet been the subject of court cases on this issue in Oregon, but a few landlords have. In one case, the landlord moved a known smoker into an apartment downstairs. When the upstairs owner became ill from the smoke, she sued, alleging the landlord had breached his statutory duty to keep the premises habitable. The jury found a breach, reduced rent 50 percent, and awarded medical costs. If an Oregon court can find a landlord in breach of duty to keep units habitable, it is not much of a step for a court to find a Board in breach of their fiduciary duty to protect unit owner's rights to enjoyment of their property. California courts have already drawn this parallel.

The question then is how to deal with the smoke infiltration? This will largely depend upon the configuration of your buildings and a case by case examination of where and how the smoke is entering units where it is unwanted. If your problem is wafting up through windows, perhaps a ban on outdoor smoking within a certain distance of any building will be enough. However, if the smoke infiltration is a result of a common ventilation system or building flaws which allow smoke to transfer from inside one unit to another

unit, the problem is more difficult to solve. The association may be forced into either fixing the building flaw that allows smoke to transfer between units, or banning smoking outright. At that point, I wish I could be more help, but it may be time to call your legal counsel for help clearing the air.

Good luck!

Dank Whetley

*\* Please feel free to email me for cites to any of the above referenced cases.*

### Got a Problem For Dank?

Please send your questions to:

[newsletter@vf-law.com](mailto:newsletter@vf-law.com)

Dank will choose a question from those received and answer it the next newsletter.



## Insurance Update: Due Care in Purchasing Insurance

One of the most important responsibilities of a Board of Directors is purchasing insurance. Premiums can be very high and so decisions about what coverage to buy have significant impact on budgeting and fiscal responsibilities. Nonetheless, it is important to insure that the community's property and liability exposure is adequately covered. The governing documents will usually have a requirement that the association purchase insurance, and may list specific types of coverage or certain risks that must be insured. More often than not, the language in governing documents is generalized and the provisions can quickly become outdated as insurance products change. The uncertainty is compounded by policy language that can be difficult to comprehend and definitions and exclusions that may have taken on special meaning through years of interpretation disputes. To compound the issue, most Directors and Officers' Liability insurance policies won't cover the Board's failure to purchase the right types or amounts of insurance coverage.

As a result, Board Members and Managers depend heavily on insurance industry representatives to help select the right coverages. In doing so, it is critical that the Board understand and define that relationship so that reliance on an agent's advice is warranted. The first question to ask your insurance professional is who they represent and how they are compensated. Some make the distinction between a bro-

ker (as a representative of the insured) and an agent (as a representative of a particular insurance company) but really your professional is an intermediary that needs to learn what risks the association is obligated to protect against, and an insurance company that will agree to accept that risk. Compensation information can provide some valuable insight. Some independent brokers charge a fee, some charge and "waive" a fee, and most all are also compensated by the carriers on a commission basis.

In late 2004, the Attorney General for the State of New York filed a suit bringing charges of fraud and antitrust violations, alleging that in some instances clients were illegally steered to insurers that paid the highest commissions, and rigged bids for insurance contracts were solicited. Along with the brokerage, several major insurance companies were named in the lawsuit, and some insurance executives pled guilty to criminal charges in connection. As a result of the suit the brokerage agreed to pay \$850 million in restitution to clients nationwide, including \$8 million to Oregon clients.

Following the scandal, the Insurance Division for the State of Oregon passed an administrative rule governing compensation of insurance professionals, which became effective in January 2006. In sum, the rule prohibits an insurance consultant that receives any compensation from a prospective insured, from also then receiving compensa-

tion from the insurance company without full disclosure and written acknowledgment from the prospective insured.

So here's what to do: First, understand what the governing documents require the association to insure. That means asking for an interpretation from your association attorney. Second, prepare a bid specification document specifically describing the requirements and the risks of loss to be insured. Include descriptions of the general types of insurance policies, i.e., commercial general liability, property insurance, directors and officers' liability and fidelity insurance. Then specify important coverage options within each type of policy. For example, a D&O policy should cover committee members and managers as additional insureds and should also include a duty to defend suits, not just pay any resulting liabilities. Property Insurance should cover replacement value and also include building code/ordinance upgrade coverage, in case there is additional cost to bring a building up to current code after a loss. It should also cover demolition and debris removal, and unpaid or uncollected assessments resulting from a covered property loss. Go through each type of policy and familiarize yourself with the optional coverages and the differences between the same policies offered by different carriers.

Once you have a well defined bid document, meet with your insurance professional and obtain the required

disclosures. You should also request a loss history, since insurers will use that information in determining the premium charged. Go over the governing documents and your bid specs with your insurance professional. Request a proposal that demonstrates that the products they recommend meet your requirements. Don't be afraid to shop or to switch representatives or insurers, but be careful to ask about gaps in coverage, particularly on D&O policies where it is important to make sure the new policy covers acts prior to the coverage period. Once you have received a proposal that addresses each of the items in your bid spec, you will have enough information to intelligently make a recommendation to purchase certain coverages.

Taking these steps will help in a number of ways: First, you will make sure that the association has adequately protected itself and the community property. Second, you will have made adequate investigation into the coverages the association is purchasing so that your reliance on your insurance professional is reasonable. Finally, you have done your homework in justifying the substantial expense, or at least maximized the coverage you can work into your budget. Insurance purchasing can be difficult, but a well planned purchase is well worth the effort in the event of a loss.

~Tom Johnson~

Vial Fotheringham LLP

## What Does “Maintenance and Repair Responsibility” Mean to a Townhouse HOA?

What is a townhouse or a rowhome? One can witness their increasing popularity by a quick scan of the Sunday Oregonian’s real estate pages or other advertisements for new housing in the Portland-metropolitan area. It is clear that the townhouse or rowhome has become a fixture in many new housing developments popping up around the region. Yet in Oregon, townhouses and rowhomes are nothing more than architec-

cause they are not treated like condominiums even though they are often built and treated like a condominium by developers. Usually the biggest problems stem from maintenance and repair of the townhouse or rowhome’s exteriors, along with the associated insurance coverage. Thus, this lack of categorical protection under Oregon’s homeowners’ laws has led to the uneven treatment of townhouses, rowhomes, their owners, and the Home

ter does not penetrate into the individual units. With these responsibilities comes the potential liability of the HOA and, potentially, its individual members if the HOA does not or cannot fulfill them. Unfortunately for the HOA, however, Oregon law is not clear about what rights the HOA has to pursue others who caused problems in the areas in which the HOA is responsible for maintaining or repairing.

Shortly after control of the association was turned over to the homeowners from the developer, the owners began to discover leaks in their units. The owners complained to the HOA and asked the HOA to take care of it. The HOA began discussing the matter with the developer and eventually sued the developer for construction defects that had resulted in the water intrusion.

This precise issue came to a head in a lawsuit involving a homeowners association made up of more than 100 townhouses. In this community, groups of townhouses were attached together with a common wall line, common roof, and party walls separating the adjacent units. According to the association’s governing documents, the HOA is responsible for maintaining and repairing the buildings’ exteriors and ensuring that water does not penetrate through the buildings’ envelopes into the individual units, and it is responsible for maintaining and repairing the exteriors of the buildings.

Early in the lawsuit, the developer then asked the court to dismiss the lawsuit on the grounds that the individual owners, not the HOA, should be bringing the lawsuit because the owners, not the HOA, owned the property. The HOA countered by arguing, among other things, that their maintenance and repair responsibility given by the association’s documents was an “interest” in the property, as the term is defined in the Planned Community Act, and that therefore they could sue the developer for construction

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tural styles of homes: they receive no special treatment or distinction under Oregon law.

For townhouses or rowhomes created as condominiums through the Oregon Condominium Act (ORS chapter 100), this lack of distinct protection is not problematic because they are treated the same as any other condominium, from ownership interests to maintenance and repair, etc. On the other hand, townhouses or rowhomes created as part of a planned community under the Oregon Planned Community Act (ORS chapter 94) face unique problems be-

Owners Associations (HOAs) that govern and administer them depending on which homeowners law they were created under.

For non-condominium HOAs with townhouses or rowhomes in their project, it is important to know and understand what rights and responsibilities they hold with respect to the maintenance, repair and replacement of the various elements of the townhouse or rowhome buildings in their community. Often, the HOA is responsible for maintaining and repairing the buildings’ exteriors and ensuring that wa-

### **NEXT PAGE:**

#### **“QUICK GUIDE TO PARLIAMENTARY PROCEDURE”**

The following page contains a simple Robert’s Rules of Order motions guide. This guide will be adequate for most activities in a homeowner association. Only when a particularly contentious issue arises should the association need to go beyond the provisions of this simple guide. The author is quick to note that this information is not original with the author and is found in many publications and treatises on the subject. It has been organized here to facilitate usage by a homeowner association and its management. ~Rich Vial

# QUICK GUIDE TO PARLIAMENTARY PROCEDURE FOR HOAs

NOTE: The following motions are listed in order of precedence. A motion can be introduced if it higher on the list than the motion currently being considered.

Motion	Is A Second Required?	Is it Debatable?	Is it Amendable?	Vote Necessary
ADJOURN	Yes	No	No	Majority
RECESS	Yes	No	Yes	Majority
TABLE	Yes	No	No	Majority
PREVIOUS QUESTION	Yes	No	No	2/3rds
LIMIT DEBATE	Yes	No	Yes	2/3rds
POSTPONE	Yes	Yes	Yes	Majority
REFER	Yes	Yes	Yes	Majority
AMEND	Yes	Yes	Yes	Majority
MAIN	Yes	Yes	Yes	Majority
<b>The Following Motions Must be Decided Immediately Regardless of Any Pending Motion Above:</b>				
POINT OF ORDER	No	No	No	None
APPEAL	Yes	Varies	No	Majority
SUSPEND RULES	Yes	No	No	2/3rds
DIVISION	No	No	No	None
POINT OF INFORMATION	No	No	No	None

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## HOA GUIDE TO PURPOSE AND OPERATION OF 13 BASIC MOTIONS FOR ROBERT'S RULES OF ORDER

<b>Adjourn</b>	Highest precedence; if passed, the meeting is over.
<b>Appeal</b>	The means by which a member of the assembly can challenge the decision of the chair after a point of order is raised. Depending on the type of decision Robert's Rules of Order allows for debate by the assembly. A majority vote is needed to overturn the chair by appeal.
<b>Division</b>	Merely requires the chair to ask for a raise of hands or stand up to respond to the
<b>Limit Debate</b>	Must be specific in the limitations being imposed upon the parties participating in the debate. The motion itself is not debatable, but does require a two-thirds vote. It can be amended
<b>Main Motion</b>	The principal question being brought before the assembly. Though counter-intuitive, it is of lowest priority or precedence and can only be made when no other question is pending before the assembly.
<b>Point of Order</b>	A request to the chair to recognize that a procedure has been violated. It is the chair's prerogative in answering at all times.
<b>Point of Information</b>	Provides the opportunity for a member of the assembly to request information directly of the chair. It is the chair's prerogative on how to respond to a point of information.
<b>Postpone</b>	Allows a motion to be moved to a subsequent meeting for action.
<b>Previous Question</b>	Ends debate and is not debatable. Because this limits deliberation, requires a two-thirds vote.
<b>Recess</b>	High precedence; if passed, the body must take a break. Usually the time for the break is stated in the motion to recess.
<b>Refer</b>	Allows a motion to be referred to a committee or some smaller body of the assem-
<b>Suspend Rules</b>	Must state the specific rule, and requires a second. There is, however, no debate and it requires 2/3rds to approve.
<b>Table</b>	High precedence; not debatable and not amendable; simply removes the question from the assembly so that it can get on with other business. A motion which is tabled expires upon adjournment.

*continued from page 4*

defects in areas that are within their maintenance and repair obligation. A Washington County judge agreed with the developer and dismissed the case saying that the individual owners and not the HOA was the proper party to bring the lawsuit. The issue is currently on appeal in front of the Oregon Court of Appeals and a decision is expected sometime later this year or early 2007.

The problem with the court's ruling is that while it recognized and acknowledged the HOA's obligation to maintain and repair the buildings' exteriors, it nonetheless refused to allow the HOA to chase others who were responsible for the problems the HOA had to repair. In doing so, the court placed all the liability on the HOA without

providing it a means for alleviating or mitigating that liability. It also undermined the fundamental nature and protection of HOAs by requiring individual owners to bring the lawsuit. Owners whose units or buildings do not have problems are deprived of the benefit of a funding source (lawsuit recovery from the developer) for the assessments that they will have to pay the HOA to effectuate repairs. Conversely, owners whose units and buildings are damaged would receive a windfall by prevailing in a lawsuit against the developer because they could use those funds to pay their share of the HOA assessments for the repairs (while likely recovering more than their assessed share).

So why do HOAs care? Well, a Clackamas County judge just recently disagreed

with the Washington County court and held that the HOA is the proper party in the lawsuit. This split in judicial authorities has led to uneven results in litigation involving townhouses and rowhomes where the HOA has a maintenance and repair interest. While the HOA's liability is clear if it fails to perform its responsibilities, it is unclear whether the HOA can pursue those who are ultimately responsible for the HOA's problems. For example, it is unclear whether an HOA can sue a roofer for failing to install a new roof on a set of rowhomes because the damage is to property that does not belong to the HOA.

In short, non-condo HOAs with maintenance and repair responsibilities on townhouses and rowhomes are in a precarious position.

These associations must use sound judgment in carrying out these responsibilities to avoid liability down the road. Members of the HOA's board of directors should review the HOA's governing documents (declaration and bylaws) to determine the exact scope of the HOA's maintenance and repair responsibilities.

Finally, if the Oregon courts do not recognize the precarious position that HOAs are in, then ultimately a legislative fix will be necessary. Should that be necessary, HOAs should band together to lobby Salem for help in protecting themselves and their owners.

~Chris Tingey~

Vial Fotheringham LLP

## Getting to Know Vial Fotheringham: Meet Our Law Clerks

*(continued from back cover)*



**Ryan Harris**- Ryan joined VF as an extern this year after his first year at Brigham Young University's J. Reuben Clark School of Law. Ryan holds a degree in Russian from BYU. Ryan will leave VF for 5 weeks for an externship in Scotland. He will return to VF after his trip to Scotland as a paid clerk. Ryan spent a year photographing and fingerprinting suspected criminals while working for the Provo Police Department.



**Dylan Hydes**- Dylan holds a B.S. in History and Political Science from Linfield College and a M.A. in Education from the University of Oregon. Dylan taught 7<sup>th</sup> and 8<sup>th</sup> grade social studies for four years. This fall he will begin his second year at Lewis and Clark's Northwestern School of Law. Dylan is a huge baseball fan and also enjoys following politics.



**Michael Montag**- Michael studied in Minnesota at Carleton College where he received his degree in Economics. He then spent three years in Washington D.C. where he worked with federal transportation policy as a research analyst. This is Michael's first year at VF. This fall he will begin his second year at Lewis and Clark's Northwestern School of Law. Michael is a motorcycle enthusiast and rides his motorcycle to work as often as weather permits.



**Ashley Yorra**- Ashley joins us after her first year at Lewis and Clark's Northwestern School of Law. Ashley studied at Reed College where she received a degree in Classics-Religion. Ashley defined her career path at a young age, when to her parents at age 6 she declared, "I'm going to Reed and I'm going to be a lawyer." While living in Florida, Ashley spent much of her free time volunteering at the Dolphin and Whale Hospital caring for sick dolphins and whales.



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## Getting to Know Vial Fotheringham: Meet Our Law Clerks

*At Vial Fotheringham we strive to surround ourselves with talented people. In this issue of our newsletter we felt we should introduce you to the clerks who do so much hard work for us.*

See page 7 to meet the other clerks.



**Jason Grosz**— Jason has just graduated from Lewis and Clark's Northwestern School of Law. His B.A. is from the University of California San Diego. He is now preparing for the Oregon bar exam. Jason has been with VF for three years as a law clerk and is expected to do great things in his future here as an attorney. Jason enjoys running and has been in several events including half-marathons and the Hood to Coast Relay.



**Mike Vial**- Mike studied at Oregon State University where he received degrees in Philosophy and Political Science. This fall he will begin his third year at Lewis and Clark's Northwestern School of Law.

Mike has been with VF for several years as a law clerk and hopes to continue as an attorney. Mike is a dog lover and often fosters dogs from the local pet shelter in an effort to find them good homes.



**Amy Phillips**- This will be Amy's second year at VF. Amy studied Economics at Whitman College and will start her last year at Lewis and Clark's Northwestern School of Law in the fall. Amy grew up in Walla Walla, Washington. Amy has, in her varied travels, visited all but two continents of the world. Before too long she hopes to visit the last two, Antarctica and Africa.

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