

CONDOMINIUM ASSOCIATIONS GET A BREAK — OR DO THEY?

by *Steve Sowell**

On October 22, 1994, President Clinton signed the Bankruptcy Reform Act of 1994¹ ("the Reform Act") into law. The many and varied provisions of the Reform Act include some much-needed protection for Condominium Associations and Cooperatives when a co-owner² files for Chapter 7 bankruptcy.³ Section 309 of the Reform Act, entitled "Fairness to Condominium and Cooperative Owners," amends Section 523(a) of the United States Bankruptcy Code⁴ ("the Bankruptcy Code") to exempt from dischargeability any fee or assessment which falls due after the bankruptcy petition is filed (i.e., postpetition⁵ assessments), provided that the fee is payable for a period during which the debtor either physically occupied the unit, or rented the unit and received payments from the tenant for the period. Section 309 adds a new §523(a)(16) to the Bankruptcy Code, which states that a discharge under any of the chapters of the Bankruptcy Code does not discharge an individual debtor from any debt:

(16) for a fee or assessment that becomes due and payable after the order or relief to a mem-

bership association with respect to the debtor's interest in a dwelling unit that has condominium ownership or in a share of a cooperative housing corporation, but only if such fee or assessment is payable for a period during which —

(A) the debtor physically occupied a dwelling unit in the condominium or cooperative project; or

(B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case.⁶

Before passage of the Reform Act, there was a split of authority among bankruptcy courts as to the dischargeability of postpetition condominium assessments.

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Some courts analyzed each case to determine whether and when the co-owner vacated the property, and held this to be the determining factor in liability for postpetition assessments.⁷ Other courts simply held that all postpetition assessments are discharged.⁸ Still others held that, until the co-owner is divested of title, the co-owner remains liable for assessments.⁹

Section 309 is an attempt to make uniform the treatment of condominium and cooperative assessments by codifying the occupancy test which some courts had espoused before the Reform Act. Under §523(a)(16) of the Bankruptcy Code, one looks at whether and when the co-owner occupied the property (or whether and when the co-owner received rent for the property if it is a rental unit) to determine when the co-owner's liability for assessment ends. However, the language of §523(a)(16) is subject to differing interpretations and is difficult to reconcile with both the Michigan Condominium Act and provisions commonly seen in Michigan condominium documents.

For example, §523(a)(16) refers to "a fee or assessment **that becomes due and payable** after the order for relief." [emphasis added] Many older condominium documents provide for payment of general¹⁰ assessments monthly, although the recent trend has been to make the general assessment a yearly assessment payable in monthly installments, to aid in collections by providing for acceleration of the remaining balance of the annual assessment upon default by the co-owner. In the case of a chronically delinquent co-owner, the association usually pursues collection only once a year, even though installments are payable monthly. However, under §523(a)(16) it remains to be litigated whether such an annual assessment is due and payable when levied or is due and payable only when each monthly installment falls due. If a co-owner files for bankruptcy the day after an annual assessment is levied and the court finds that the assessment was due and payable when levied, rather than when each installment falls due, the association may lose an entire year's worth of assessments. Those associations with annual assessments may therefore wish to consider revising their documents to avoid this problem.

In order for the assessment to be nondischargeable, §523(a)(16) mandates that it must be payable for a period during which the co-owner either physically occupied the unit, or rented the unit out and received rent from his tenant. This language appears to be directed at the general assessment; however, most condominium documents also provide for additional and special¹¹ assess-

ments. Additional and special assessments may be levied to fund budgetary shortfalls, emergencies, and replacements and/or additions to the general or limited common elements. While the fiscal year of the association presumably determines whether an additional assessment for budgetary shortfalls occurs during "the period" involved, this is not certain. Also, how does one determine what "the period" is for a special assessment levied in order to add a swimming pool to the project? Is the period determined by the date of adoption of the assessment by the board or membership, or is it the date the addition or improvement is actually started or completed? Is it the due date for the assessment as determined by the board? Obviously, §523(a)(16) raises a number of interesting questions with respect to additional and special assessments. It may be advisable for the Board of Directors to spell out when the special or additional assessment becomes due and payable, either in the resolution adopting the additional assessment or in the language presented to the co-owners for vote on a special assessment.¹²

Section 523(a)(16) creates evidentiary problems. Subsection (A) requires the debtor to have physically occupied the unit, but does not define physical occupation. In Michigan, with its many snowbirds, a co-owner may actually live in a sun-belt state for several months of the year. Will the co-owner be found to "physically occupy" the unit if he is not in the state for several months of the year? Is it enough that the co-owner keeps furniture in the unit? What effect does the debtor's residency have on the issue? A prudent association attorney will garner as much evidence as possible to establish the debtor's ties to Michigan in an attempt to demonstrate to the court that the debtor "physically occupied" the unit even though the debtor lived somewhere else. Important evidence may include the co-owner's driver's license, voter registration, vehicle registration, tax returns, and mailing address.

Section 523(a)(16) creates other evidentiary problems. For instance, it requires that the debtor receive payments from a tenant for the period in issue. The association may have to engage in discovery with the debtor to determine what, if any, rent the debtor received and for what month the rent was due. The association also may wish to subpoena the tenant's records to verify the statement of the debtor. What effect does the association's right to demand rent directly from the tenant for payment of the condominium assessment¹³ have? What about situations where the debtor is in the middle of a rent dispute with the tenant and the tenant is escrowing money¹⁴ until the dispute is resolved? Is the

debtor considered to have received the rent if it is in escrow, or does the debtor's liability for assessments turn on the outcome of the rent dispute?

Note that Section 309 refers to "dwelling unit": presumably, this provision does not apply to business condominiums, but what about other forms of condominiums? The author has represented campground condominiums as well as boat dock condominiums. Will units in any of these non-traditional condominiums be considered dwelling units for purposes of §523(a)(16)?

In one respect, Section 309 of the Reform Act has not gone far enough: §523(a)(16) covers the debtor's interest in a dwelling unit that has **condominium** ownership; however, there are a multitude of homeowner associations that are allowed by their Declaration of Restrictions¹⁵ to collect assessments, but which do not come under the definition of "condominium" or "cooperative housing association." On the other hand, the language is arguably broad enough to allow the collection of fees by a master or umbrella homeowner's association if the condominium unit is a part of the master association. This leads to the anomaly that homeowner association dues on a single family home may not be collectible, unlike homeowner association dues on a condominium in the same planned unit development. The author would have preferred that Congress use a term such as "community association" or "common interest ownership association" such as is used in the model acts.¹⁶

The practitioner should realize that §523(a)(16) of the Bankruptcy Code affects only co-owners who file bankruptcy under Chapter 7; bankruptcies filed under Chapter 11 and Chapter 13 are governed by different rules which require a debtor to propose a plan that provides for payment of the current monthly assessments as well as cure of the arrears.¹⁷

While Section 309 of the Bankruptcy Reform Act, and its creation of §523(a)(16) is a good start, it may ultimately lead to more problems than it has cured. Given the fact that the association is usually arguing with the co-owner/debtor about a relatively small amount of money, it may take quite a while before all of the ins and outs of the new provision are delineated because few associations will have either the inclination or the financial resources to litigate the unresolved issues and to make law, notwithstanding that the Michigan Condominium Act allows the Association to recover attorney fees if successful.¹⁸ Perhaps the better approach may be for condominium attorneys to return to Congress to obtain some reform to the Bankruptcy Reform Act of 1994.

ENDNOTES

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1. Public Law 103-394; 108 Stat. 4106.
2. "Co-owner" is a term of art defined by the Michigan Condominium Act (MCLA §559.101 *et seq.*) in MCLA §559.106(1). This article is written from the perspective of a condominium association; issues will likely be different for a cooperative housing association.
3. There are three types of bankruptcies that an individual co-owner may file: a straight liquidation (Chapter 7), a "wage-earner's" reorganization (Chapter 13), and a "business" reorganization (Chapter 11). Although individuals may be family farmer debtors (Chapter 12), it is unlikely that farmland would be held as condominium property.
4. 11 USC §101 *et. seq.*
5. A bankruptcy case is started by the filing of a petition. 11 USC §101(42). The filing date is usually the defining date for determining liability on debts pursuant to 11 USC §727; obligations are thus referred to as having been incurred "prepetition" or "postpetition."
6. 11 USC §523(a)(16).
7. **Cohen v North Park Parkside Community Association**, 122 BR 735 (Bankr. S.D. CA 1991); **In re Miller**, 125 BR 441 (Bankr. W.D. PA 1991); **In re Montoya**, 95 BR 511 (Bankr. S.D. OH 1988).
8. **In re Turner**, 101 BR 751 (Bankr. D. UT 1989); **Matter of Behrens**, 900 F2d 97 (7th Cir. 1990); **Matter of Rosteck**, 899 F2d 694 (7th Cir. 1990).
9. **In re Raymond**, 129 BR 354 (Bankr. S.D. NY 1991). **See also Alexandria Knowles West Condominium Homes Council of Co-owners v Strelsky**, 46 BR 178 (Bankr. E.D. VA 1985); **Horton v Beaumont Place Homeowners Association**, 87 BR 650 (Bankr. D. CO 1987); **In re O'Mara**, 141 BR 237 (Bankr. M.D. FL 1992).
10. "General" assessment is not a term of art under the Michigan Condominium Act. The author is referring to assessments that are derived by calculating the needs of the association for the year and multiplying that by the co-owners' respective percentages of value.
11. "Additional" and "Special" assessments are not terms of art; they are taken from the language of many condominium bylaws which refer to an assessment levied by the Board of Directors of the condominium association as an additional assessment and an assessment which requires a vote of the co-owners (and sometimes mortgagees) to be adopted as a special assessment. However, the terminology is not uniform among condominium documents and has led to endless confusion between board members, managing agents, and even judges.

12. This is a good idea in any event, so that prospective sellers and purchasers of condominium units can allocate payment of assessments at closing. Disputes have arisen as to when an assessment has become due under some purchase agreements, where the parties have to depend upon boilerplate language intended to cover general property assessments.
 13. MCLA §559.211(5).
 14. MCR 4.201(H)(2)(a).
 15. "A rose by any other name. . . ." William Shakespeare. The documents which define a homeowner association have also been referred to as Declarations of Planned Unit Developments, Declarations of Covenants and Conditions, Easement and Restriction Agreements, and no doubt numerous other titles.
 16. See e.g., the Uniform Common Interest Ownership Act.
 17. 11 USC §1322(b)(5) provides that a default on a secured debt on which the last payment is due after completion of the Chapter 13 plan may be cured under the plan within a reasonable time. Most bankruptcy practitioners treat condominium assessments as debts which fall under this provision because the assessments continue to accrue as long as the debtor owns the unit; presumably, ownership will continue after the debtor's case is concluded.
 18. MCLA §559.206(b).
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