CC&R Legal Clarification

The following information is being furnished to all members of the Estates of Shady Hollow Home Owners Association. This is a list of questions that were presented to our Association's attorney concerning the legal interpretation of various Declarations in our CC&R's.

June 19, 2003

Re: Estates of Shady Hollow Legal Questions

Contents:

Thank you for your inquiry. In your email you asked several legal questions, and this letter will lay out my answers to them.

1. Question: What are the lengths of the director's terms? Some feel the length is one year while others feel the length is two years.

Answer: I can see how members would be confused, because your declaration and bylaws are in direct conflict. In the event of a conflict, the declaration prevails.

The declaration in article 4, section 2, provides for two year, staggered terms, where three members are up one year and two members are up the next year. What should have happened is at the first annual meeting of the members after December 31, 1992, two directors should have been elected for one year and three directors should have been elected for two years, and thereafter every other year two directors are elected for two years and three directors are elected for two years. The language of the declaration is very clear, it states, "…at each annual election thereafter [after 1992] the successors to the class of directors whose term shall expire that year [there are two class 1 directors and three class 2 directors] shall be elected to hold office for the term of two years, so that the term of office of one class of directors shall expire in each year."

This is a fancy way of saying the directors have staggered terms, two are elected every other year and three are elected every other year, all for two year terms.

However your bylaws are very clear and are very clearly in conflict with the declaration. Article 4 of the bylaws state "The term of office of the directors shall be fixed at one year." The declaration would be the controlling instrument, and you should go by the declaration and not the bylaws. Please note that you would still go by the bylaws with regard to officer elections (your bylaws state that officers are elected each year) so the directors would elect a new set of officers each year, which makes sense because in any given year at least two directors have a potential to leave the board.

2. Question: Is it typical that ACC decisions are final with no recourse on the part of the homeowner?

Answer: Yes, this is typical. Just about all declarations say something like, "The decision of the board" or "the decision of the ACC" is final. This does not prevent an owner from suing the association claiming that it is arbitrarily enforcing its rules (for example, enforcing its rules against non-friends of board members and not enforcing its rules against friends of board members, etc.) or otherwise directly violating the declaration in enforcing its rules, but the short answer to your question is yes, it is quite common and frankly it is advisable that the architectural committee's decision, (or the board's decision—whoever the declaration vests the final decision with) is final.

3. Question: Are you aware of any HOAs that allow the first review of submitted plans to be accomplished by a third party, such as the property management company, with an appeal to the ACC?

Answer: No, I am not aware of any associations that work exactly like that. Most associations that I work with receive initial feedback from either an architect or their management company or both regarding their thoughts on the compliance of the project, and then the ACC (or the board if the board is vested with the authority) considers those suggestions and makes its final decision. If you wanted to delegate the final decision making authority to some body (some entity or person) other

than the ACC, in my opinion that would take a declaration amendment because article 6, section 1 of your declaration is quite clear that the ACC has sole and final authority.

4. Question: Currently the ACC on occasion walks the property of a homeowner that has made a submittal. Several homeowners took exception to this practice. If a homeowner isn't asking for a variance from the CC&Rs and refuses to allow the ACC to walk their property, can the refusal be the basis for denying approval?

Answer: In some circumstances I certainly think it would be reasonable or even necessary for ACC members, or an architect reviewing the plans, to walk the property to get an idea of the topography, setbacks, etc. That being said, the declaration does not specifically give ACC members the right to access the property in contemplating its decision. So, in the unfortunate circumstances where owners are unreasonable in refusing the ACC's reasonable request to inspect I think you have two choices. In order to try to avoid situations like this in the future, you could (1) amend the declaration by two-thirds vote of a quorum of the members present at a meeting of the association to specifically give the ACC the authority to inspect, or (2) you could use your rulemaking power given to you in bylaw article 6, section 1(b) to require that owners submitting plans to the ACC must allow the ACC reasonable access to the property in their review of the plans. If either of these items were in place, then I think you would have much firmer ground to stand on in refusing to approve the plans on the basis of lack of access.

5. Question: The CC&Rs seem to give a great deal of discretion to the ACC and this has led some HOA members to feel that the ACC can/has approved or disapproved regardless of the CC&Rs. With such perceived discretion, what liabilities do the ACC and HOA members incur? Specifically, if legally challenged, do the board, HOA, or ACC members have personal liability?

Answer: None of the members should have personal liability unless their actions were outside of the scope of their duties and rights as a board/ACC member or unless they were in bad faith and willful. Several provisions govern the liability and indemnification of your directors, officers, and ACC members.

First of all, your bylaws in article 8, specifically require the association to indemnify every director or officer for expenses reasonably incurred by him in connection with any action unless the director is a party by reason of his being a director or having been a director (There is an exception for gross negligence or willful misconduct.) So, if a director is personally named and the suit against him is related to his position as a board member/officer, then the association must indemnify him unless it is found that the director acted in gross negligence or with willful misconduct. This article of the bylaws, however, does not apply to ACC members.

If you have directors and officers insurance (which you probably do) the directors and officers insurance should cover committee members such as ACC members and should cover their legal fees (again there will probably be an exception in the policy for willful misconduct—you can ask

your insurance agent) but if you would like to pursue this further you would probably be well served to touch base with your D&O carrier to make sure that ACC members are also covered. It is my understanding that committee members are normally covered under a D&O policy.

There is also a provision in article 8, section 5 of your declaration which says that any party buying into the Estates of Shady Hollow agrees that he will not bring any action or suit against any director, officer or ACC member. Although this is better than nothing, I am not confident that a judge would enforce this, especially in a circumstance which might be considered egregious (such as perceived self-dealing discrimination, etc.), so I would not rely fully on this.

The Texas Nonprofit Corporation Act also provides some important liability protections. Article 1396-2.22 of the Texas statutes states that an officer of a nonprofit corporation is not liable to the corporation (association) or any other person (an association member) for an action taken or omission made by the officer in the person's capacity as an officer unless the officer acted in a manner which was not in good faith, with ordinary care, as long as the officer reasonably believed the action to be in the best interests of the association. So, officers are given quite a bit of liability protection under the Nonprofit Corporation Act.

Regarding directors, article 1396-2.22A gives a corporation the authority to indemnify directors as long as they have not acted in bad faith, and requires corporations to indemnify directors against expenses incurred by the director in connection with a proceeding in which the director is named as a defendant because of his position as a director if he has been wholly successful in the defense of the proceedings (if it is found that the director did not act in bad faith.)

This same section also gives a corporation (your association) the power to indemnify and advance expenses to employees or agents of the corporation (a committee member would in my opinion be an agent of the corporation) to the same extent that the corporation may indemnify or advance expenses to directors.

So, in summary, the directors and officers, by virtue of the combined protection of your bylaws and the Nonprofit Corporation Act, should be indemnified in every situation in which they are named as a party because of their status as director or officer except those situations involving gross negligence or willful misconduct on behalf of the director or officer. It is not as clear with committee members since they are not specifically addressed in your bylaws. Under the Nonprofit Corporation Act you have the authority to indemnify/pay the expenses for committee members who are sued because of their status as committee members, but you do not have a mandate to do so by your bylaws or state statute.

6. Question: You also asked me to perform an overall review of article 6 and article 7 of your declaration dealing with the ACC and land use/construction. You asked me to identify ambiguities in requirements, and what rules are enforceable and what rules aren't.

Answer: I can't give you a hard and fast answer in response to a general question—it would be easier to propose certain fact situations and then I could give you a detailed response. However, in general I would be happy to comment on my opinion of these two sections.

Beginning with article 6 regarding the Architectural Control Committee, in my opinion all of the provisions in this article are legal and enforceable. The provisions in this article are fairly typical of ACC provisions in other declarations that I have reviewed. The ACC (or the board if there is no ACC) is generally given broad authority to make sure that the houses are constructed of an acceptable material, in an acceptable location, design, color, etc. so that the neighborhood maintains a harmonious character.

What you might want to do to help with consistency (because there is inevitably confusion/hard feelings because when the ACC has new members, inevitably new members have different thoughts on what is appropriate and what isn't) you may consider having the ACC adopt some written policies, which could be changed but would serve as a benchmark. In section 1, for example, the ACC has the right to specify a limited number of acceptable exterior materials and/or finishes and has the right to specify requirements for each tract with respect to the location, height and extent of fences, walls or other screening devices and the orientation of the structure with respect to access and major entry and frontage. You could formulate policies and put them in writing, with the caveat that the ACC reserves the right to depart from the policies (allow a taller/require a shorter house, etc.) if circumstances in their opinion warrant exceptions. This way, homeowners wishing to add on to a house, build a new house, etc. would already have a pre-approved list of acceptable materials. Obviously they would still need pre-approval from the ACC, but it would probably facilitate the process.

As an aside, you are correct that the ACC is given very broad powers to reject anything that "in the sole discretion of the ACC is not compatible with the design or overall character and aesthetics of the Shady Hollow Estates project." This is a perfectly legitimate power to give to the ACC, and if an owner objected to it in court, most likely the test would be whether the ACC was arbitrarily or capriciously exercising its power.

7. Question: You asked for some overall comments on article 7 regarding land use.

Answer: In general I think this section is pretty clear but there are some ambiguities, most of which you have pointed out.

Article 7, section 1 states "No building of any kind, with the exception of lawn storage or children's playhouses shall ever be moved on to any Tract, it being the intention that only new construction shall be placed and erected thereon."

In my opinion the proper legal interpretation of this is that no pre-fabricated building of any kind, with the exception of a building for storage of lawn equipment or a building comprising a children's playhouse, is allowed on the property at all. Recall, however, that even a pre-fab-type lawn storage or children's playhouse must meet the article 7 requirements and must be pre-approved by the Architectural Control Committee to be in conformance with the harmony of the neighborhood, etc.

Additionally, note that article 7, section 2 states that "Further, buildings shall only be constructed out of brick, exposed aggregate concrete, wood, glass, and other such materials as are approved by the ACC." So, the ACC clearly has the authority to require lawn storage buildings or children's

playhouse buildings, even though they might be pre-fabricated, to be made out of brick, concrete, wood, glass, or any other material approved by the ACC.

As to what “lawn storage building” and “children's playhouse” means, this is fairly open ended. Arguably any type of storage building in a back yard used for storage of lawn equipment could be considered a lawn storage building. Any type of playhouse, playscape, etc. obviously meant for children's play could be considered a children's playhouse. The ACC will have to determine in its discretion what constitutes a lawn storage building or a children's playhouse. Again, this is only actually relevant if someone wants to move a pre-fabricated building on the property—because the only pre-fab buildings allowed are lawn storage buildings and children's playhouses. This is a rather insignificant distinction being that the ACC still has the right to approve all materials for any buildings, including any pre-fab lawn storage buildings or children's playhouses.

You have noted that in the past some “affordable portable” type buildings have been approved and some outbuildings have been required to be brick/masonry. While it is always helpful to have consistency, it is not imperative as long as there is not an arbitrary or capricious reason for the inconsistency. For example, the ACC may see fit to allow an “affordable portable” type of building when it is in a place where no other home has a view of it. Topographical considerations, etc. might determine the ACC's permission or rejection. Also, obviously the composition of the ACC changes over time and their views on what is aesthetically harmonious might change over time. This is obviously not an ideal situation but it is a fact of working in an association that has turnover of officers and committee members. Again, as long as the rules are not enforced in an arbitrary or capricious manner they should be enforceable.

At some point, however, you approach the problem with a waiver. For example, if for years the association has allowed “affordable portable” type buildings to be constructed in any situation (not just situations where there are specific circumstances warranting such a permission), then a homeowner could go to court and show a pattern of behavior by the association and argue that the association has waived it right to disallow “affordable portable” type buildings in all situations. A homeowner's success with this argument will depend on many factors, including the prevalence of these types of buildings, whether these types of buildings have been approved only in limited circumstances, etc. A similar analysis would apply to the children's playhouse situation.

As to what is a “front entry garage”, article 7, section 5 states “The door of the garage on any Tract shall not face the front property line of such Tract.” This is obviously subject to reasonable interpretation by the ACC. If you would like me to I can try to look up some case law to see if there is any on this point, but I think a reasonable interpretation would certainly be that the side entry (90°) angle is required. However, as you noted there is precedent set that a garage at an angle to the street has been approved. This inconsistency could be problematic because homeowners could argue that in the past the association has interpreted this provision to mean that garages can't be parallel to the street but they may be slightly offset from the street. It would probably help your case (to continue to enforce the 90° requirement) if the 13° garage door that was approved had a lot with peculiar topography such that a 90°/side angle garage would have been difficult or impossible to construct. Again, this may be something that you could note in the written policies of the ACC, since the ACC per article 6, section 2 has the authority to specify requirements for the orientation of the structures within the property.

As to what “screening” or “public view” mean under article 7, section 7, the short answer is they mean whatever the ACC says they mean. Items such as boats, camping rigs, etc. must be “properly screened from public view in a manner approved in writing by the ACC.” So, the ACC is going to use its discretion, and as long as it is not abusing its discretion and not acting arbitrarily or capriciously, its discretion should be upheld. However, if it has established a precedent that this type of screen is okay for RVs, this type of screen is okay for boats, then absent unusual circumstances, it will probably need to approve the same type of screening for future boats, RVs, etc. Again, I would recommend that something regarding screening be put in some written policies from the ACC since they do have this right under article 6, section 1 (the right to specify requirements for each tract with respect to screening devices.)

I also noticed in article 7, section 12 that the ACC has the right to adopt rules and regulations regarding pets, so if they are adopting rules and there are additional rules you would like to adopt regarding pets (designated defecation areas, etc.) that can be done in the ACC policies. With respect to article 7, section 14, there is nothing illegal about this section (regarding antennas) but please keep in mind that under federal law, the association cannot place unreasonable restrictions which may interfere with reception of owners. So, for example, you could require all antennas/satellite dishes to be placed in the back yard or behind screening, but if the homeowner cannot receive reception from that area, you will have to make exceptions. You cannot totally prohibit satellite dishes/antennas, with the exception that you can prohibit satellite dishes more than one meter in diameter.

I hope this has been of assistance to you in analyzing your declaration provisions. Please give me a call with any questions. Thanks.

Sincerely,

Niemann & Niemann, L.L.P.

By: _____

Connie N. Heyer