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No. 99138-3

SUPREME COURT
OF THE STATE OF WASHINGTON

MATT SUROWIECKI, SR.,

Petitioner,

and

LARRY BANGARTER; ALEX AND ELENA BORROMEO; CAMP FIRE SNOHOMISH COUNTY; CAROL BRITTEN; JAMES WAAK, individually and as lot owners and derivatively on behalf of HAT ISLAND COMMUNITY ASSOCIATION, a Washington non-profit corporation,

Plaintiffs,

v.

HAT ISLAND COMMUNITY ASSOCIATION, a Washington non-profit corporation, CHUCK MOTSON, an individual; KAREN CONNER, an individual; ALAN DASHEN, an individual; SUSAN DAHL, an individual; and JOHN DOES 1-10, individuals,

Respondents.

BRIEF OF AMICUS CURIAE
COMMUNITY ASSOCIATIONS INSTITUTE

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I. INTRODUCTION

The statutory process for homeowner ratification of proposed budgets and assessments, and the additional approvals required under the governing documents of certain communities like Hat Island Community Association ("HICA"), protects the interests of homeowners in self-governance, sound fiscal management, and finality. When the prescribed process is followed, the outcome should be respected and not subject to judicial review absent evidence of fraud, dishonesty, or incompetence. The Court of Appeals erred in failing to apply that standard and in adding a novel "vetting" requirement to the budget and assessment approval process.

II. IDENTITY AND INTEREST OF AMICUS CURIAE

Community Associations Institute ("CAI") is an international organization dedicated to providing information, education, resources and advocacy for community association leaders, members and professionals with the intent of promoting successful communities through effective, responsible governance and management. CAI's more than 40,000 members include homeowners, board members, association managers, community management firms, and other professionals who provide services to community associations. CAI is the largest organization of its kind, serving more than 73 million homeowners living in more than 350,000 community associations in the United States.

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There are 64 CAI chapters throughout the United States and abroad. Among them is the Washington State Chapter ("WSCAI"), which was founded in 1973. With more than 2,100 members, WSCAI is CAI's third-largest chapter. See www.wscai.org. More than 2.3 million of Washington State residents, or about 30% of the state's population, live in nearly 10,500 community associations (primarily homeowner and condominium owner associations). See WA_FactsFigures.pdf (caionline.org) (2019 figures). WSCAI provides education, advocacy and resources for these communities.

CAI has a substantial interest in fostering best practices and predictability in homeowner association financial management, especially the process governing homeowner approval of budgets and assessments, which impacts every community association and every owner, every year. The statutory process for approval of budgets and assessments has been carefully designed to provide certainty and finality. The Court of Appeals' holding runs counter to those policy objectives and injects uncertainty and confusion into the budget and assessment approval process for thousands of homeowner associations across the state.

III. STATEMENT OF THE CASE

CAI adopts the Statement of the Case set forth in the Supplemental Brief of Respondent Hat Island Community Association and the factual background presented in the Court of Appeals' opinion. *See Bangerter v.*

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Hat Island Community Association, 14 Wash. App. 2d 718, 723-730, 472 P.3d 998, 1001-1005 (2020).

IV. ARGUMENT

A. The Law Specifies a Process for Owner Approval of Budgets and Assessments

The law specifies a default procedure for approval of budgets and assessments in community associations. At the time of the assessment decisions at issue in this case, HICA's budget and assessment process was governed by the Homeowner Association Act, RCW Chapter 64.38, as supplemented by HICA's Bylaws. The HOA Act required that, within thirty days after adoption of a budget by the board of directors, the board

> set a date for a meeting of the owners to consider ratification of the budget …. Unless at that meeting the owners of a majority of the votes in the association are allocated or any larger percentage specified in the governing documents reject the budget, the budget is ratified, whether or not a quorum is present. In the event the proposed budget is rejected …, the periodic budget last ratified by the owners shall be continued until such time as the owners ratify a subsequent budget proposed by the board of directors.

RCW 64.38.025(3) (emphasis added).

HICA's Bylaws established a more stringent procedure for owner approval by providing that the proposed annual assessment amount, if changed from the prior year, "will be presented to the community for approval during the annual meeting of the Association …." *See Bangerter*, 14 Wash. App. 2d at 725 (quoting bylaws). Approval of an increased

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assessment amount required the "affirmative vote" of a majority of all members in good standing. *Id*. at 724. HICA's assessment approval process, during a year when there is a change in the annual assessment amount, thus requires more than ratification resulting automatically from the failure of a majority of owners to reject.

The budget ratification default rule in the HOA Act was superseded, for both new and pre-existing communities, by the Washington Common Interest Ownership Act (WUCIOA), RCW Chapter 64.90, which took effect July 1, 2018. Under RCW 64.90.525(1)(a), the budget proposed by the board and the assessments based on that budget are ratified by operation of law if they are not rejected by a majority of the voting power at the ratification meeting. This procedure applies to residential common interest communities, like HICA, created under prior law, and inconsistent provisions under the HOA Act no longer apply. RCW 64.90.080(1).

The mandatory statutory procedure for ratification of annual budgets and assessments is intended to protect the interests of homeowners in self-governance and sound fiscal management and provide certainty. If a majority of owners do not agree with a proposed budget/assessment, they can reject it. "The provisions of paragraph (a) permit the unit owners to disapprove any proposed budget …." Official Comment 2, Uniform

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Common Interest Ownership Act (2008) § 3-123 (Adoption of Budgets, Special Assessments).

This approach, however, is by no means uniform across the nation. In Oregon, for example, the board of directors adopts an annual budget without owner approval, then assesses owners in accordance with it. *See* ORS 94.645 and 94.704(5)(a). By contrast, Washington's budget and assessment approval process provides owners with the opportunity to block a budget and corresponding assessments by simple majority vote. It follows that the outcome of the prescribed budget and assessment approval process, if followed, should be accepted as the will of the association, and not second-guessed by the courts.

B. HICA Followed the Process for Owner Approval of the Proposed Assessments

HICA followed the process specified in the HOA Act and the HICA Bylaws for seeking and obtaining owner approval of its approved budget. Each year, the Board of Trustees developed a budget for the coming year and submitted it to the members of the association for ratification. (CP 1698, ¶12 & Exh. F (CP 1763-1782).) If the budget included a proposed increase in the annual operating assessment, a vote of the membership was held. (CP 1698, ¶12.) As provided in the bylaws, the affirmative vote of a

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majority of the votes in the association approved each increase. (*See id*. & ¶13.)

Since the process specified in the bylaws was followed – a process more stringent and participatory than the statutory default – the outcome should be conclusive. Implicit if not explicit in the board's proposal of an equal assessment for each lot was its determination that this allocation constituted "an equitable basis" for funding the operation and maintenance of the original common facilities, as provided by the CC&Rs. (CP 856, ¶21.) "When an instrument involving real property is properly recorded, it becomes notice to all the world of its contents." *Strong v. Clark*, 56 Wn.2d 230, 232, 352 P.2d 183, 184 (1960). Lot owners are charged with actual or constructive knowledge of recorded covenants, including in this case the requirement that assessments be charged on an equitable basis. By approving the proposed assessments, the owners determined that the assessments were charged on an equitable basis. The court's conclusion that the record does not show that the owners considered whether the uniform assessment structure was equitable flies in the face of established property law norms.

Moreover, the court's conclusion is at odds with its own recitation of the facts, which show that different assessment approaches were debated. As noted by the Court of Appeals, the HICA Board "considered requests by

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lot owners to modify the assessment structure." *Bangerter*, 14 Wash. App. 2d at 727. In fact, it "specifically considered Surowiecki's request that the assessments be allocated based on each lot's tax-assessed value." *Id*. The board held several community meetings seeking owner input regarding the method for allocating assessments, considered differing opinions, and ultimately "decided" to continue allocating assessments equally among lots. *Id*.

The process worked as intended. Owners including Surowiecki had the chance to present requests to modify the equal assessment approach and the opportunity at community meetings to discuss the merits of different approaches. The board fulfilled its responsibility by proposing assessments to the membership that it decided best met the needs of the community. If the owners believed that the equal assessment proposed by the board was not equitable, they had the power to reject it and send the board back to come up with a different approach. Not only did the owners fail to reject the equal assessment approach, on at least four occasions since 2010 a majority voted affirmatively to approve an increased equal assessment. (CP 1698, ¶13.) This record of community approval should be conclusive, final, and not subject to judicial review absent evidence of fraud, dishonesty, or incompetence.

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C. A "Thorough Vetting" by the Members of Alternative Assessment Approaches is Neither Contemplated Nor Appropriate

In its opinion, the Court of Appeals held that it was "impossible to determine if HICA's board and its members ever made a formal decision to retain the existing assessment structure [i.e., equal assessments for all lots] or to reject Surowiecki's proposed alternative." *Bangerter*, 14 Wash. App. 2d at 740. It said that it could not determine if the owners voted to maintain the equal assessment approach "because they have considered the options and deem it to be equitable or because they were advised that uniformity was mandated by HICA's bylaws." *Id*. And it concluded that if HICA retained the uniform structure "because, after a thorough vetting at community meetings, the membership concluded the current structure is as equitable as any other," then a trier of fact could find the approved assessment reasonable. *Id*. at 740-41.

The court erred in creating this novel vetting requirement, and in looking behind the approval process despite the absence of a sufficient evidentiary basis to do so. As discussed above, the governing statutes – the HOA Act before July 1, 2018 and WUCIOA after that date – specify a clear procedure for owner approval or rejection of proposed budgets and assessments. If a proposed budget and assessment are not rejected by a majority of the voting power, they "are ratified, whether or not a quorum is

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present." RCW 64.90.525(1)(a) (emphasis added). HICA's governing documents require even more – the affirmative approval of a majority to approve any change in an existing assessment. The statute does not say that the assessment is ratified (and the HICA Bylaws do not say that the proposed assessment is approved) *only if* the association shows that all alternative approaches were considered and thoroughly vetted by the membership. No such vetting requirement exists, and none should be implied by this Court under the guise of interpreting governing documents.

The imposition of a vetting requirement is particularly unwarranted where, as here, the record shows that the community considered alternative methodologies. "The record indicates that, in response to grievances over its assessments, HICA and its board considered requests to modify the assessment structure. It specifically considered Surowiecki's request that the assessments be allocated based on each lot's tax-assessed value. The board held several community meetings seeking owner input into the issue of the assessment allocation." *Bangerter*, 14 Wash. App. 2d at 727. Notwithstanding this record, the court concluded: "From this record, it is impossible to determine if HICA's board and its members ever made a formal decision to retain the existing assessment structure or to reject Surowiecki's proposed alternative." *Id*. at 740. The court did not specify what kind of "formal decision" it had in mind and instead remanded for

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fact-finding on whether the process employed and facts considered were reasonable. *Id*. at 741.

Fact finding to determine the thinking behind a community's vote to approve a budget and assessment proposed by the board is inconsistent with the prescribed statutory process for budget and assessment ratification and the process specified in the HICA governing documents for owner approval of assessments. Neither ratification by operation of law under RCW 64.90.525 nor approval by owner vote should be subject to impeachment merely because a disappointed owner asserts that the methodology used was not "equitable." What is "equitable" in a given circumstance is usually debatable. *See Chrobuck v. Snohomish County*, 78 Wn.2d 858, 876, 480 P.2d 489 (1971) ("The appearance of fairness is in the eyes of the beholder.").

A budget and assessment approval decision by the members of a homeowners' association made in adherence to proper procedures should not be thrown into doubt because the court does not know what the owners "believed" and cannot discern whether a "formal decision" was made to select one assessment methodology over another. The budget/assessment approval process <u>is</u> the formal decision contemplated by the statute and the governing documents. Once the court determines that the budget and assessment were approved using the prescribed process, the decision of the

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members should be final and not subject to review absent evidence of fraud, dishonesty, or incompetence.

A vote by the members of a homeowners' association to approve (or reject) a proposed budget and assessment should be treated like a jury verdict. "The individual or collective thought processes leading to a verdict 'inhere in the verdict' and cannot be used to impeach a jury verdict." *Breckenridge v. Valley Gen. Hosp.*, 150 Wn.2d 197, 204–05, 75 P.3d 944, 949 (2003). "A strong affirmative showing of misconduct" is required to overcome the policy favoring stability. *State v. Balisok*, 123 Wn.2d 114, 117-18, 866 P.2d 631 (1994). *Cf. Washington State Labor Council v. Federated Am. Ins. Co.*, 78 Wn.2d 263, 271, 474 P.2d 98, 103 (1970) (election of directors upheld absent showing of "fraud, bad faith or overreaching on the part of the company officers in allocating and casting the disputed votes"); *Dumas v. Gagner*, 137 Wn.2d 268, 283–84, 971 P.2d 17, 25 (1999) (unless an election is "clearly invalid," the judiciary should "exercise restraint in interfering with the elective process which is reserved to the people in the state constitution").

A similar showing should be required before collective action by the members of a homeowners' association, taken pursuant to statutory procedures, can be impeached. The Court of Appeals' remand for a factual determination into whether HICA's members consciously decided that the

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uniform assessment proposed by the board was equitable is inconsistent with the goal of stability and certainty. The court's approach would throw budgets and assessments for common interest communities into doubt and create unwarranted opportunities for litigation challenging the "thinking" behind assessment decisions.

The ratification/approval process builds in ample opportunity for owner input and objection. Once the proposed budget and assessment is approved, it should carry finality and certainty, absent evidence of fraud, dishonesty, or incompetence.

D. Under the Business Judgment Rule, Approval by HICA's Membership of the Assessments Should be Respected Absent Evidence of Fraud, Dishonesty, or Incompetence

Several cases recognize that board decisions (i.e., board judgments), not just individual decisionmakers, can be protected by the business judgment rule. *See In re Spokane Concrete Products,* 126 Wn.2d 269, 279, 892 P.2d 98 (1995) (internal citations omitted) ("Unless there is evidence of fraud, dishonesty, or incompetence (*i.e.,* failure to exercise proper care, skill, and diligence), courts generally refuse to substitute their judgment for that of the directors." As noted in *Davis v. Cox*, 180 Wash. App. 514, 535, 325 P.3d 255 (2014), *reversed on other grounds*, 183 Wash.2d 269 (2015), "[b]y virtue of being tasked with managing the corporation, the board may avail itself of the business judgment rule." (Emphasis added.) "The

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business judgment rule cautions against courts substituting their judgment for that of the board of directors, absent evidence of fraud, dishonesty, or incompetence." Id.

The court in *Schwarzmann v. Assn. of Apartment Owners of Bridgehaven*, 33 Wash. App. 397, 403, 655 P.2d 1177 (1982), discussing the business judgment rule, concluded that, "[a]bsent a showing of fraud, dishonesty, or *incompetence*, it is not the court's job to second-guess the actions of directors." (Underline added, italics in original.) *See also Nursing Home Bldg. Corp. v. DeHart*, 13 Wash. App. 489, 498, 535 P.2d 137 (1975) (courts "are reluctant to interfere with the internal management of corporations and generally refuse to substitute their judgment for that of the directors") (underline added); *Shorewood West Condominium Ass'n v. Sadri,* 92 Wash. App. 752, 756, 966 P.2d 372 (1998)*, reversed on other grounds,* 140 Wn.2d 47, 992 P.2d 1008 (2000) ("Courts also apply the business judgment rule to actions of an owners association, holding its members liable for their decisions only if they benefited to the detriment of other owners.") (underline added); *Hoy v. The 400 Condominium Association*, 9 Wash. App. 2d 1047 (2019) (unpublished and non-binding; cited pursuant to GR 14.1(a)) ("The business judgment rule protects the decisions made by a board tasked with managing a corporation.") (underline added).

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An Official Comment to the Model Business Corporation Act states that corporate "decisions will not be disturbed by a court substituting its own notions of what is or is not sound business judgment if the board's decisions can be attributed to any rational business purpose." Official Comment to Model Business Corp. Act § 8.31 (2016 Revision) (emphasis added).[1] Other jurisdictions likewise recognize that the business judgment rule protects corporate decisions, not just individual corporate actors. See Supplemental Brief of Respondent HICA, at 10-11.

The Court of Appeals concluded that the business judgment rule "limits only personal liability of individuals [and] does not immunize corporations." *Bangerter*, 14 Wash. App. 2d at 737. This conclusion is inconsistent with the cited decisions and in any event is at odds with the purpose and policies underlying the business judgment rule.

> Ordinarily, the decisions made by a condominium association board should be reviewed by a court using the same business judgment rule that governs decisions made by other types of corporate directors. The business judgment rule limits the judicial review of decisions made by a condominium's board of managers to whether the board's actions are authorized and whether the actions were taken in good faith and in furtherance of the legitimate interests of the condominium. It can be gleaned from the case law that so long as a condominium board acts for the purposes of the condominium,

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[1] The Official Comments "may be used as persuasive authority." *Humphrey Industries, Ltd. v. Clay Street Associations, LLC*, 170 Wn.2d 495, 504 n.9, 242 P.3d 846 (2010).

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> within the scope of its authority and in good faith, the courts will not substitute their judgment for that of the board's.

George Blum, Annotation, *Application of Business Judgment Rule to Decisions by Real Estate Condominium or Cooperative Corporations*, 9 A.L.R.7th Art. 5, at Introduction (2016). As noted by a recognized authority, the business judgment rule

> defends the procedure under which the board has acted and the right of the board to be the sole arbiter of the issue involved. The result is that <u>if the procedure is valid, the court will not second guess the substance of a board's action</u>. Consequently, the court upholds the decision without subjecting the wisdom of the board's action to judicial scrutiny. . . First, the rule encourages competent people to serve by providing a degree of 'safe harbor.' Second, it acknowledges that making decisions involves a degree of risk and thus protects discretion without 'second guessing' the decision. Third, it provides for judicial efficiency in that it keeps courts from becoming involved in decisions that are better made by those closer to the situation or with greater skill or understanding.

Hyatt & French, *Community Association Law: Cases and Materials on Common Interest Communities* 301-02 (Carolina Academic Press 1998) (emphasis added).

In light of the statutory procedure for ratification of assessments, augmented in this case by the association's more stringent requirement of affirmative owner approval, and the purpose and effect of the business judgment rule, the analysis in the present case should have had two steps: first, was submission of the proposed assessment to the owners for approval within the HICA Board's authority; second, if it was, and the assessment

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was approved by the owners, did the challenger present any evidence of fraud, dishonesty or incompetence to justify judicial review.

The trial court effectively applied this standard, concluding that the decision of the owners should be respected and not second-guessed by the court absent evidence sufficient to overcome the protection of the business judgment rule. (See CP 11-13.) Regarding the evidence presented, the trial court concluded that, "[a]t best, what the (inadmissible) evidence presented by Plaintiffs show[s] is a difference of opinion as to what course should be taken. Ultimately, there was a vote among members and Plaintiffs' position did not prevail." (CP 13.)

The Court of Appeals erred in rejecting application of the business judgment rule and requiring evidence of a "thorough vetting" of the competing assessment methodologies before accepting the decision of the membership. *See Bangerter*, 14 Wash. App. 2d at 740-41. Its ruling creates an entirely new judicial hurdle to budget and assessment approval that lacks any basis in the HOA Act, WUCIOA, or the HICA Bylaws. The court's ruling cannot be justified on the basis of covenant interpretation.

E. Incanting the Word "Inequitable" Does Not Entitle a Dissenting Owner to Judicial Review of a Duly Ratified or Approved Assessment

Interpretation of an association's governing documents presents a question of law and courts apply the rules of contract interpretation.

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Wilkinson v. Chiwawa Communities Association, 180 Wn.2d 241, 249, 327 P.3d 614, 619 (2014). The word "equitable" as used in connection with homeowner association assessments was judicially interpreted in 1997, in *Ackerman v. Sudden Valley Community Association*, 89 Wash. App. 156, 164, 944 P.2d 1045 (1997). As the Court of Appeals noted in this case, "Under Ackerman, the homeowner association and its members have the discretion to decide what type of assessment structure is 'equitable.'" *Bangerter*, 14 Wash. App. 2d at 740.

Since the provision in the HICA covenants on which Surowiecki relied in objecting to the association's assessment had already been judicially interpreted, and that interpretation validated as permissible the uniform assessment approach proposed by the HICA Board and approved by vote of its membership, further judicial interpretation was unnecessary. That is the case even if the HICA Board did not know whether it had the discretion to propose non-uniform assessments. *Cf. Groves v. Progressive Casualty*, 50 Wash. App. 133, 138, 747 P.2d 498 (1987) ("Groves was not prejudiced merely because the arbitrators reached the correct result based on an erroneous rule of law.").

Surowiecki's brief, however, contends that the requirement for "equitable" assessments allows him to challenge both the procedural and the substantive fairness of the approval decision by the membership. He is

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mistaken. The requirement that assessments be equitable does not entitle a challenger to overturn a duly ratified and approved budget and assessment simply because he can articulate reasons why a different approach might be more equitable. If it did, no approval decision would be final in associations where the governing documents call for equitable assessments. So long as a challenger could mount arguments as to why he or she felt the board's chosen approach was "inequitable," the court would be drawn into the game and invited to substitute its judgment for that of the board and the association of owners that approved the assessment.[2]

Surowiecki reveals his intention to draw the courts into these matters when he argues that an association cannot be protected from liability "by levying *inequitable* assessments" or by "simply deferring" to one party's interpretation of a contractual duty. Supplemental Brief of Petitioner at 23 (emphasis in original). The Court should not take the bait. If submission of a proposed assessment to the owners for approval was within the board's authority and the assessment was duly approved by the owners, the assessment should only be subject to judicial review if the challenger presents evidence of fraud, dishonesty or incompetence (i.e., failure to

[2] *Rodruck v. Sand Point Maintenance Commission*, 48 Wn.2d 565, 295 P.2d 714 (1956), cited by Surowiecki, is inapposite. It preceded the HOA Act by 39 years and WUCIOA by 62 years, and the governing documents in that case contained no process for owner ratification or approval of assessments proposed by the board.

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exercise proper care, skill, and diligence). *See Riss v. Angel*, 131 Wn.2d 612, 632, 934 P.2d 669 (1997).

This standard provides ample room for review and correction of corrupt or incompetent decisions, while respecting the finality of homeowner self-governance decisions in the absence of such evidence. It does not, as Surowiecki labors to assert, condone arbitrary board decisions or deprive the courts of their role in interpreting covenants. Having failed to present evidence of fraud, dishonesty, or incompetence, Surowiecki's attempt to leverage the word "equitable" into a cause of action to invalidate the outcome of a faithfully executed assessment approval process should be rejected.

V. CONCLUSION

The decision of the Court of Appeals should be reversed and the judgment of the trial court reinstated.

DATED: April 12, 2021.

RAFEL LAW GROUP PLLC

By: *___/s/ Anthony L. Rafel_____*
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Attorney for Amicus Curiae Community Associations Institute

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CERTIFICATE OF SERVICE

I certify that on April 12, 2021, I caused true and complete copies of the foregoing Brief of Amicus Curiae Community Associations Institute to be served on all counsel of record at the addresses and in the manner indicated below:

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