

## HOA Brief Newsletter

### Tips for the HOA Community

#19

#### “YAY! I’m on the Board.” or, “OMG, What Did I Get Myself Into?”

Boards serve a necessary function in any corporation, especially within an HOA. It would be impossible for an association to function without one. In an association, the buck ultimately stops with the board. The board is elected by the members of the association to accomplish the tasks required of an association by the governing documents. Volunteer board members are accountable to the association itself, as well as to the owners within the community. While the board can, and should, rely on opinions of experts and information presented by committees, decisions affecting the community are the ultimate responsibility of the board, and the board members will be held accountable for these decisions. Even though the position is voluntary, board members should take their fiduciary responsibility to the association and its members seriously.



Despite the important role the board plays in the association, board members must keep in mind that they have been elected by the members to conduct the business and affairs of the association. Board members should not become power hungry or otherwise harass owners. Likewise, owners must respect the authority of the

board to conduct the association's business and enforce its governing documents.

Board members should remember that the owners must be kept informed of the board's activities and make sure to maintain proper communication with the other owners. In deciding what to communicate to the members, the board members should consider what they would like to know and how they would like to be treated as a non-board member owner and strive to act in that manner as a board member.

#### **Fiduciary Duty & Business Judgment Rule**

In addition to the duties set forth in the Articles of Incorporation, CC&Rs, and the Bylaws, board members have additional duties imposed by law. While all of the duties and obligations of a board member cannot reasonably be set forth in a short article, we will highlight some of the most important duties and obligations new board members must understand: that of their fiduciary duty to the association and its members, the business judgment rule, and the duty to keep communications with the association's attorney confidential.

All board members have a fiduciary duty to act in the best interests of the association. The fiduciary duty is the highest duty of care and loyalty recognized by law. It is the same duty owed by a doctor to a patient and an attorney to a client. So, what does the fiduciary duty require of each director? The fiduciary duty requires directors to act

with undivided loyalty; to act in good faith; to deal fairly; and to put the best interest of the association and the members before their own personal interests. A board member may not place his or her own personal interests ahead of the association or the membership.

Newly elected directors are often unsure how to meet their obligations to the association and its members and fulfill their fiduciary duties. A director's actions are judged under the standard of the "business judgment rule," which is set forth in California *Corporations Code* section 7231. Simply put, the "business judgment rule" requires that a director act in a way which he or she believes would be in the best interests of the association and its members. In meeting this obligation, board members may (some would argue *must* when the board members lack the required expertise on a subject) rely on information, opinions, reports or statements from experts whom the board members believe to be reliable and competent regarding the issues the board is evaluating. In addition, the board may rely on information, opinions, reports or statements prepared by: "[o]ne or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented," or, so long as the board member is not a member of the committee, they may rely on a committee of the board on matters related to its authority. In addition, a board member may rely on the advice of a third party on matters related to the third party's expertise. However, whenever a board member is considering the advice of a committee or a third party, they cannot rely on the advice if they have knowledge of facts which would call into question the competence of the individuals presenting the advice. If board members

meet this standard, they will have fulfilled their obligations to both the association and the members.

Notice that the business judgment rule requires "action" (you must act in such a manner that you believe to be in the best interests of the corporation; act in good faith...); the business judgment rule does not protect board members when they fail to take action. Therefore, it is important to actually make a decision on an issue, any decision, so long as it is reasonable based on the situation, in order to have the protection of the business judgment rule. Board members should not avoid dealing with an issue they know about if it requires board attention. They should investigate, gather facts, seek expert advice, or even decide to revisit an issue if it is not an emergency. But in order for the board to obtain the protection offered by the business judgment rule, some action must be taken. Simply tabling an item does not provide the protection of the business judgment rule if the item needs the attention of the board.

As part of the decision-making process, under the business judgment rule, board members have a duty to make "reasonable inquiry" when making a decision. This not only gives a board member the opportunity for good legal, accounting or other expert advice, but it offers board members the ability to protect themselves and the association from liability. A board should not use limited financial resources as an excuse for not seeking the advice of their legal counsel, CPA or other expert regarding an issue. Meeting this "reasonable inquiry" requirement provides both the board members and the association a significant amount of protection from liability that they would not otherwise have.

## Attorney Client Privilege

All communications between the board and its attorney are privileged. That means the contents of the communication, whether written or oral, are confidential and cannot be disclosed to a third party. The privilege is held by the association, not the attorney or the individual board members. Individual board members may not disclose the contents of a privileged communication without full board approval. A board member should not discuss attorney client communications with anyone other than other board members and management. While it may be tempting and seem harmless, sharing these types of attorney client communications with a spouse, a neighbor, a work colleague, etc., can not only result in a loss of the attorney client privilege, but may expose the director to personal liability for failing to maintain his or her fiduciary duty to the association. Therefore, individual board members should never act on their own to disclose privileged communications.

The attorney client privilege is an important right. It is designed to allow the board to candidly discuss and disclose information to and from its attorney. Waiving the attorney client privilege should not be done lightly or without careful consideration and thought.

## Conclusion

There are many duties and responsibilities with which newly elected or appointed board members must be familiar. In addition to knowing and understanding their fiduciary duties, board members must familiarize themselves with various financial oversight requirements, such as the obligation to review financial statements at least every three months, to investigate and make reasonable inquiry on matters relating to member discipline, and others.

Understanding and acting in compliance with the business judgment rule will go a long way to ensuring that the board is satisfying its fiduciary responsibility to the association and its members. Any board member who is unclear on how to satisfy the business judgment rule and meet his or her fiduciary obligation with respect to any particular issue should contact the association's legal counsel.

We provide this newsletter for advertising and general informational purposes only. It is not intended to create an attorney client relationship. Readers should not act on any issues raised in this newsletter without consulting with legal counsel.



Ph: (949) 654-1510

Robert M. DeNichilo, Esq., CCAL

Email: [robert@NDHOALaw.com](mailto:robert@NDHOALaw.com)

Website: [NDHOALaw.com](http://NDHOALaw.com)

dlnl19 06082012 - fixed.docx