



An Overview of Fiduciary Duties of California Common Interest Development Directors and Officers

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The purpose of this document is to provide community association board members with practical information designed to assist them with understanding the legal structure of common interest developments, and board member and homeowner responsibilities under that structure. This information can help guide board members through the complex issues that arise in the everyday administration, management and governance of a condominium project, planned development or other community association. The information below provides a general overview of some of these common issues, and is not tailored to any specific association or intended to cover all issues a board may face. A board should consult with association legal counsel regarding any questions it has on the applicability of the items below to the board and/or the association.

I. OVERVIEW OF COMMON INTEREST DEVELOPMENT GOVERNANCE

- Most common interest developments (also known as a community associations, homeowners associations or, simply, associations) in California are non-profit mutual benefit corporations, and the remainder are unincorporated associations.
 - Generally speaking, whether an association is incorporated or not has no effect on the laws applicable to the association or the rights and obligations of the association, its board of directors and its members (also known as homeowners).
 - There are certain instances in which it is beneficial for an association to be incorporated; for example, in the event of a catastrophic disaster, an unincorporated association would likely not be eligible to receive financial assistance from the Federal Emergency Management Agency (known as “FEMA”), as the association is not a formal legal entity.
 - California associations that are non-profit mutual benefit corporations are organized and exist under California’s Nonprofit Mutual Benefit Corporation Law (Cal. Corp. Code § 7110, *et seq.*)

- A common interest development is governed by a board of volunteer directors elected, for the most part, by the members of the association.
 - These directors have the same fiduciary duties as boards of large corporations such as McDonald's, Intel and Texaco. The difference is that the conduct of these board members will be compared to the conduct of other non-profit mutual benefit corporation board members.
 - Board members must act in accordance with the Business Judgment Rule, and their conduct may come under scrutiny in a court of law.

- The association's governing documents, typically the association's bylaws, will establish the qualifications for directors and candidates for the board.
 - These qualifications can include, among other things, that board members (1) be a member of the association, (2) be current in the payment of assessments, (3) not be in violation of the association's governing documents, (4) not be in an adversarial legal proceeding or litigation against the association, (5) not be related to another board member by blood, marriage or personal relationship and/or (6) not share joint ownership interest in a unit/lot with another board member.
 - Some governing documents will limit the number of terms a director can serve.

- Generally speaking, the officers of the association are a President, Vice President, Secretary and Treasurer, and are appointed from and by the Board unless the association's governing documents state otherwise.
 - The President generally presides over all meetings of the association's members and board, and (subject to the control of the board) has general supervision, direction and control of the day-to-day business of the association. The President is sometimes titled as the Chief Executive Officer of the association.
 - The Vice President generally performs all of the duties of the President in the absence of the President (and when so acting has all the powers conferred upon the President), and has such other powers and duties as may be prescribed by the board or the association's governing documents.
 - The Secretary generally keeps the minutes of all board and member meetings (this duty may be delegated to the association's managing agent, however the Secretary must sign the minutes), gives (or cause to be given) notices of all board and member meetings and maintains a record book of member and resident information, among other duties.
 - The Treasurer generally has responsibility for overseeing the association's funds, financial reporting, tax preparation and filing, budget preparation, deposit of assessments and payment of vendor invoices, among other duties. The Treasurer is sometimes titled as the Chief Financial Officer of the association.
 - An association may have additional officers such as a Second Vice President, Assistant Secretary or Assistant Treasurer.

- Officers serve at the pleasure of the board, and the board (being an affirmative vote of a majority of the board members) can reorganize officers as desired.
- The board has the authority, subject to the association's governing documents, to create committees to assist the board with its duties.
 - All committees ultimately take direction from the board, and committees and their members serve at the pleasure of the board.
 - An advisory committee contains one or more association members who are not board members. These committees provide advisement to the board on certain issues, and that input is advisory only (and not binding). Examples of advisory committees are facilities committees, social committees and finance committees.
 - An executive committee contains only board members (at least two), and the board can delegate some of its powers and duties to that committee (but there are certain things that cannot be delegated to an executive committee). Examples of executive committees are enforcement committees, personnel committees and litigation committees.
- The members of the association are those persons and entities (*e.g.* corporations, limited liability companies and trusts) who are on record title to a unit/lot.
 - Only the association's members (and not tenants or residents not on title) have a right to vote on association business and receive required disclosures and notices.
 - Once an owner sells or transfers their unit/lot they are no longer a member of the association, and an owner's membership in the association cannot be separated from the ownership of the owner's unit/lot.
 - All members are generally presumed to have equal rights and obligations, except with respect to certain multi-class voting rights, variable assessments and exclusive use common areas.
- The association and its members and board are subject to the requirements of the association's legal/governing documents and applicable state and federal statutes.

II. LEGAL DOCUMENTS

Following is a summary of the main governing documents that association members and boards, and association managing agents and legal counsel, deal with on a regular basis.

- Articles of Incorporation.
 - This document contains the primary rules governing the management of the association and establishes the specific, primary and general purposes for which the association is formed.

- The Articles are filed with the California Secretary of State's office, and bi-annual forms and fees must be submitted to the Secretary of State. If the forms and fees are not submitted, or the association does not file tax returns with or pay taxes due to the Franchise Tax Board, the association's corporate status can be suspended.
- An unincorporated Association will not have Articles of Incorporation, but may have Articles of Association.
- The Association's developer/declarant generally initially files the Articles. However, unincorporated associations may choose to incorporate later.
- Bylaws (also known as By-Laws).
 - This document is concerned with the operation of the association and sets out the form, manner or procedure in which the association should be run.
 - Bylaws vary from association to association, but generally cover topics such as how directors are elected, how meetings and the business of the association's members and directors are conducted, member voting rights, powers and duties of the board and what officers the organization will have and a description of their duties.
 - Bylaws are generally drafted by the association's developer/declarant.
 - Bylaws cannot be amended by the association's board of directors alone – typically either a majority of the association's members or a super-majority of the membership (e.g. such as two-thirds of the total voting power of the association) must approve a bylaws amendment, and the vote must be held by secret ballot.
- CC&Rs (also known as the “Declaration”)
 - “CC&Rs” is an acronym for “Declaration of Covenants, Conditions and Restrictions.”
 - This document primarily regulates the use, aesthetics and architectural control of the association, dictates assessment payment and other financial obligations of the members, establishes the rights of and restrictions on the association's members and residents and is an equitable servitude binding all of the owners and residents of an association.
 - Examples of items controlled by the CC&Rs include pets, nuisances, view obstructions, rental restrictions, maintenance and repair of units and the common area, association and member insurance requirements, assessment obligations and association lien rights and the board's rights to enforce the association's governing documents.
 - The California Supreme Court held in the 1994 case *Nahrstedt v. Lakeside Village Condominium Association* (8 Cal.4th 361) that use restrictions contained in an association's CC&Rs are presumptively enforceable, and such restrictions will be upheld unless it is proven that a restriction is (i) arbitrary, (ii) imposes burdens on the land which outweighs the restriction's benefits to the association's residents as a whole or (iii) violates a fundamental public policy.

- CC&Rs are generally drafted by the association's developer/declarant.
- CC&R amendments typically require the approval of a super-majority of the membership (e.g. such as two-thirds or 75% of the total voting power of the association). A board may seek to amend its association's CC&Rs by court order if a proposed CC&R amendment is not approved by the required percentage of the membership, but more than 50% of the association's members voted in favor of the proposed amendment.
- Rules and Regulations (also known as operating rules).
 - Operating rules provide specific information about the restrictions contained in the CC&Rs (and sometimes the Bylaws).
 - CC&Rs are "big picture" documents, while operating rules address matters which may not be comprehensively addressed, or addressed at all, in the CC&Rs.
 - Operating rules may address matters such as the use of the common area recreational facilities, parking, leashing of pets, noise and other nuisance issues and member discipline, including the imposition of fines.
 - Operating rules are adopted by the board, but members must be given at least 30 days to review and comment on proposed rule adoption, repeal or change, pursuant to state statute.
 - Member comments are advisory only, and not binding on the board.
 - The rules must be within the authority of the board under the association's governing documents or applicable law.
 - The rules must be reasonable.
 - Operating rules cannot alter, change or exceed the association's, members' or board's rights and obligations established under the Articles of Incorporation, Bylaws and/or CC&Rs. Rules and regulations are meant to "fill in the holes" contained in those documents.
 - Within 30 days of adoption of an operating rule change, 5% or more of the association's members can petition the board and require a membership vote on a repeal of that rule change, subject to specific *Civil Code* requirements.
 - As with a violation of an association's CC&Rs, a violation of an association's Rules and Regulations can result in disciplinary measures being imposed against an owner, after a properly noticed hearing before the board.
- Architectural Guidelines.
 - These guidelines establish the architectural control restrictions for proposed alterations or modifications of a unit/lot or the association's common area (including exclusive use common areas).

- If the association has an architectural committee established under its CC&Rs, that committee is typically responsible for the adoption of architectural guidelines.
 - These guidelines are generally considered to be operating rules, so the board should send proposed guidelines to the members for a 30-day review and comment period.
 - The *Civil Code* requires every association to adopt architectural guidelines. Failure to have such guidelines will default the association to applicable statutory guidelines.
 - Examples of architectural guidelines may include window and door standards, paint color restrictions, set backs, altering the height or footprint of a home and installation of pools, gazebos and plants, shrubs and trees.
- Election and Voting Rules.
 - As of July 1, 2006, all common interest developments were required to have adopted election and voting rules covering the items addressed in Cal. *Civ. Code* § 1363.03, including, without limitation, secret ballot voting procedures, inspector of election requirements and restrictions related to proxies, quorum, adjourned meetings, nominations from the floor and cumulative voting.
 - These rules are operating rules, and must be submitted to the members for a 30-day review and comment period before adoption by the board.
 - If an association has not adopted these rules, a member could theoretically challenge the validity of any secret ballot vote occurring at the association since July of 2006.

III. RIGHTS & OBLIGATIONS

- The rights and obligations of the association and its members and board are primarily established in the association's governing documents (described above).
- The rights and obligations of the association and its members and board are also established in various state and federal statutory provisions.
 - The California *Civil Code* contains the Davis-Stirling Common Interest Development Act (Cal. *Civ. Code* § 1350, *et seq.*), commonly referred to as "Davis-Stirling," which specifically governs common interest developments in California.
 - Other *Civil Code* provisions, such as Cal. *Civ. Code* § 2924, *et seq.* regarding enforcement of liens, California *Vehicle Code* § 22568 regarding vehicle towing and California *Health and Safety Code* §§ 116064.1-116064.2 regarding swimming pool maintenance, also apply to community associations.

- Various California *Corporations Code* provisions are applicable to associations with respect to director rights and duties, director and member meetings, *etc.*
 - Other statutes, such as provisions of the California *Vehicle Code* apply to associations.
 - Federal statutes also apply to associations, such as the Federal Telecommunications Act, which provides a ban on certain restrictions related to the installation of antennas and satellite dishes by residents.
 - Boards need to ensure that their actions comply with both state and federal fair housing and employment laws.
 - The courts have not held that the Americans With Disabilities Act applies to associations, unless an association opens its facilities to the general public (for example only, the public can use an association's swimming pool for a fee, take tennis lessons at the association's tennis courts or rent the association's clubhouse for non-association events).
- Failure of the board to abide by its obligations and duties is a breach of the board's fiduciary duties and can lead to a potential action against the board for same.
 - Failure of an association member to comply with the association's governing documents is a violation of those documents and can result in disciplinary measures being imposed against the member to enforce the governing documents (*e.g.* warning letters, disciplinary hearings, suspension of voting and recreational use rights, imposition of monetary penalties/fines and/or litigation).
 - The board is required to uniformly enforce the association's governing documents against all members.
 - There can be no disparate treatment or discrimination against an association's members.
 - Renters/tenants cannot be treated differently than other residents. That said, the association has no privity of contract with non-members (the CC&Rs are a form of contract), and non-member violations of the association's governing documents must be enforced against the owner of the applicable unit/lot.
 - There are certain instances in which the board can make a decision not to enforce a governing document provision that causes a financial hardship to the association and/or its members, is discriminatory or otherwise in violation of applicable law or which members cannot reasonably and practicably comply with. A board should confer with association legal counsel before making a non-enforcement decision.
 - To ensure the financial viability of the association, the board must consistently and uniformly enforce the assessment collection provisions of its governing documents, including charging interest and late fees, engaging a collections agent as appropriate, recording a lien to secure the delinquent assessments and pursuing

nonjudicial foreclosure, judicial foreclosure or a money judgment for the collection of delinquent assessments.

IV. BOARD ROLES AND RESPONSIBILITIES

- The board is the governing body for the association, and is charged with the day-to-day operation, management and administration of the association.
 - Many boards engage a managing agent to oversee and implement these duties, but the board ultimately maintains responsibility for the association and the fulfillment of the board's duties.
 - That said, the board is the body/persons "driving the bus," and the board cannot delegate its duties and powers to the membership or third parties.
 - Boards should seek out the advice of their association's experts and consultants, such as association legal counsel, the association's accountant/auditor/CPA and the association's reserve study provider to assist the board in its business decisions.
 - Doing nothing is not an option! A decision not to take action is different than not making a decision at all.

- A board needs to act in accordance with the requirements of the California *Corporations Code* and *Civil Code* and its association's governing documents when engaging in association and board business. Boards need to remember to act in accordance with the Business Judgment Rule (Cal. *Corp. Code* § 7231(a)):

"A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

- To maintain protection from liability as volunteer directors, board members have a fiduciary duty to act (1) in good faith, (2) in the best interests of the association and (3) using such care, including reasonable inquiry, as an ordinarily prudent person would under similar circumstances. This requirement is further codified in Cal. *Corp. Code* § 7231.5.

- It is important for all board members, especially a new board member with no prior director experience, to research and understand their fiduciary duties to ensure that they are acting ethically in order to properly protect their individual actions and the actions of their board and the association.

The Business Judgment Rule

- The Business Judgment Rule is a presumption that directors' decisions are based on sound business judgment, which can be rebutted only by a factual showing of fraud, bad faith or gross overreaching. Acting in accordance with the Business Judgment Rule is an indication that a board member is likely acting ethically.
- Application of the Business Judgment Rule in the 1999 California Supreme Court case, *Lamden v. La Jolla Shores Clubdominium Homeowners Association* (21 Cal.4th 249):
 - The court held that it will defer to a board's authority and presumed expertise in discretionary decisions regarding the maintenance and repair of a common interest development, provided the board's decisions are:
 - Based upon reasonable investigation;
 - Made in good faith and with regard to the best interest of the association; and
 - Within the scope of authority given to the board under the relevant statutes and CC&Rs.
 - Assuming that a board was found to have acted in accordance with these factors, then the board would seemingly have committed no wrongs in performing whatever action was being questioned.
- Acting upon/after reasonable investigation and inquiry:
 - A director should independently investigate and evaluate facts particular to a situation before acting.
 - A director should consult with experts or consultants (*e.g.* legal counsel, financial manager, reserve study provider, *etc.*) when it is prudent to do so.
 - A director is entitled to rely on information, opinions, reports or statements prepared by experts and consultants.
- Acting in good faith and in the best interests of the association:
 - Directors cannot make decisions that benefit their own self-interests.
 - Directors must make their decisions ensuring that those decisions do not adversely affect the association financially, legally or otherwise.
 - Directors cannot act in the best interests of a particular group or minority interest of an association.
- Directors should also, pursuant to their fiduciary duties under Cal. *Corp. Code* §7231(a), act as an ordinarily prudent person in a like position would:
 - Acting with the level of care which persons of ordinary prudence would use in order to avoid injury to themselves or others under similar circumstances.

- Acting in a conservative manner, minimizing risks where they can reasonably be avoided in the same manner that a “prudent” person would.
- The benchmark is the basic attributes of common sense, practical wisdom and informed judgment.

Executive Session Board Meetings

- Cal. *Civ. Code* §1363.05 governs executive session meetings of the board.
- Executive session meetings are closed to the general membership.
- Executive session meetings may be held for the board to discuss and consider the following subjects:
 - Litigation.
 - Matters relating to the formation of contracts with third parties.
 - Member discipline.
 - Personnel matters.
 - To meet with a member, upon the member’s request, regarding the member’s payment of assessments.
- Executive session minutes are not to be disclosed to or reviewed by the general membership, and executive session meetings are to be only generally noted in the next member or general session board meeting minutes.
- An act done or decision made by a majority of the directors present at an executive session (or general session) board meeting duly held at which a quorum of directors is present is deemed an act of the board (Cal. *Corp. Code* § 7211(a)(8)). Even a dissenting director voting in the minority must abide by the board’s decision and must not seek to undermine such a decision.
- Parliamentary procedure is the standard for member meetings and can, by board decision, be used for executive session (and regular session) board meetings.

The Attorney-Client Privilege

- The attorney-client privilege is a legal concept that protects communications between a client and the client’s attorney, and keeps those communications confidential. This privilege applies to associations and is generally considered to be held by the board of the association.

- The general requirements for a valid assertion of attorney-client privilege in California are:
 - The asserted holder of the privilege is (or sought to become) a client;
 - The person to whom the communication was made is a member of the bar of a court, or that person's subordinate, and in connection with the communication is acting as an attorney;
 - The communication relates to a fact of which the attorney was informed by the attorney's client;
 - The communication was made without the presence of strangers;
 - The communication was made for the purpose of securing primarily an opinion on law, legal services or assistance in some legal proceeding, and not for the purpose of committing a crime or tort;
 - The privilege has been claimed; and
 - The privilege has not been waived.

- The attorney-client privilege does not necessarily apply to board members that happen to be attorneys.

Highlighted Duties of Directors

- **Duty of Knowledge** – The board is responsible for enforcing the association's governing documents, so board members should know the contents and requirements of the association's governing documents (*e.g.* CC&Rs, Bylaws, Articles of Incorporation, operating rules, architectural guidelines, *etc.*). The board is also responsible for managing the daily affairs of the association, so the board should be continually reviewing and evaluating association business, records and transactions.

- **Duty of Financial Management** – The board is responsible for managing the finances of the association, including the levying and collection of homeowner assessments, review of financial records and distribution of required disclosures.

- **Duty of Maintenance** – The board is responsible for the maintenance, repair and replacement of the association's common area components (for example only, exterior and structural portions of the association's buildings and improvements). The board should be aware of and plan for potential and actual deferred maintenance issues.

- **Duty of Operation** – The board is responsible for the operation and management of the common area facilities and amenities, such as pools and clubhouses. The board is also responsible for contracting and paying for services for the association (*e.g.* janitorial services, landscaping, utilities, *etc.*). And, boards need to deal with foreclosed properties

and abandoned units sitting vacant that are not being properly maintained by the current owners.

- Duty of Enforcement – The board is responsible for enforcing the association’s governing documents, including: enforcement of use restriction violations; delinquent assessment collection (the board should assess late charges, interest and collection costs for the collection of delinquent assessments); and architectural restrictions. The board is also responsible for imposing suspension of voting rights and membership privileges as a disciplinary action against homeowners for violation of the governing documents, if allowed under the governing documents, and this discipline should be applied uniformly and consistently. Directors should be aware of their responsibility in neighbor-to-neighbor nuisance disputes versus association to owner disputes.
- Duty of Leadership – Effective and ethical board members are:
 - Future oriented.
 - A team player.
 - Self-disciplined.
 - An active participant.
 - An appropriate delegator.
 - Open and willing to learn about the community and their duties.
 - Connected to the community and its values.
 - Passionate about the success of the association and its members.

Protection from Personal Liability

- Pursuant to Cal. *Civ. Code* § 1365.7(a), directors will not be held personally liable for their actions that result in damages to the association or its members in excess of the association’s insurance coverage if the following requirements are met:
 - The association maintains director’s and officer’s insurance coverage in minimum amounts of \$500,000 for an association with 100 or less separate interests or \$1,000,000 for an association with more than 100 separate interests.
 - The director’s act or omission was performed within the scope of the director’s duties, in good faith and was not willful, wanton or grossly negligent.

V. THE DAVIS-STIRLING ACT AND YOU

- The Davis Stirling Common Interest Development Act (Cal. *Civ. Code* § 1350, *et seq.*) provides the statutory framework in which community associations must operate. Davis-Stirling governs essentially all aspects of the operation and governance of common interest developments.

- Generally speaking, Davis-Stirling is intended to supplement rather than supersede an association's governing documents. However, if there is a conflict, Davis-Stirling would typically override an association's governing documents; in limited cases an association's governing documents may trump Davis-Stirling (this is also true in certain instances with respect to Davis-Stirling and certain *Corporations Code* provisions).
- Many of the Act's provisions, such as those concerning reporting and disclosure requirements, reserve funds and election procedures, are designed to protect the interests of an association's members.
- The volume and complexity of the Act's reporting and disclosure requirements are such that associations are generally required to enlist the services of a professional property manager and other qualified professionals in order to navigate and comply with the Act's provisions.