



## Legal Update Newsletter

October 2010

Welcome to the latest edition of **Silldorf & Levine, LLP's Legal Update Newsletter!**

If you have not yet updated your records, our **San Diego office** location recently relocated:  
5060 Shoreham Place, Suite 115  
San Diego, CA 92122  
PHONE: (858) 362-9602  
FAX: (858) 625-3901

You can also contact our **Orange County** location:  
18101 Von Karman Avenue, 3rd Floor  
Irvine, CA 92612  
PHONE: (949) 225-4470  
FAX: (858) 625-3901

If we can provide you or your association with our Legal Reference Guide or answer a legal questions regarding community association law, please contact:

**Christina Ciceron, Esq.**  
**E-mail:** [cciceron@silldorf-levine.com](mailto:cciceron@silldorf-levine.com)  
**Toll Free 800-811-5874**

# Is Under-Budgeting a Breach of a Board's Fiduciary Duty?

Homeowner association board of directors have a duty to act in the best interest of their community and their members. Acting against that interest may give rise to a legal action against a director or the entire board of directors. Many times, we have fielded the legal question of whether a board's over-estimation of an association's revenues, and under-estimation of its expenses, (which naturally leads to a shortfall in the association budget), constitutes a breach of the board's fiduciary duty to the community and its members. The short answer to that question is no. The long answer rests on the "business judgment rule" that governs the board's decisions.

The "business judgment rule" is codified in California Corporations Code section 7231, and essentially states that if directors act in good "business judgment," their decision is protected from liability. To be protected by the "business judgment rule," a board's decision must comply with the following five standards:

- **The decision must be based on reasonable investigations and findings;**
- **In making the decision, the board must reasonably believe that it is in the best interest of the association and its members;**
- **The decision must be made in good faith;**
- **The decision must be reasonable in light of the circumstances;**
- **The decision must be within the association's authority under the law and the governing documents.**

If a board properly follows these five standards when establishing its budget, but nevertheless falls short in its calculation, the "business judgment rule" should protect it from liability.

In the 1999 landmark decision *Lamden v. La Jolla Shores Condominium Association*, the California Supreme Court approved this view. There, the court concluded that although an association may be unincorporated, and therefore not subject to the California Corporations Code, it is subject to the business judgment rule. The court stated, "where a duly constituted community association board, upon reasonable investigation, in good faith and with regard for the best interests of the community association and its members, exercises discretion within the scope of its authority under relevant statutes, covenants and restrictions to select among means for discharging an obligation to maintain and repair a development's common areas, courts should defer to the board's authority and presumed expertise."

Of course, it is not always easy to determine whether a course of action is reasonable or in the best interest of the association. Questionable decisions should always be reviewed by an attorney. Often, a written legal opinion by an association's counsel may be the most important piece of evidence in showing that an association acted reasonably and that the "business judgment rule" protection should apply.

## **Notice Requirement Prior to Filing A Construction Defect Lawsuit**

Strict procedures must be followed when a homeowner association files a civil action against the developer for damage to common areas, or separate interests that the association is obligated to repair.

Under California Civil Code § 1368.5, an association must provide written notice to each member of the association that appears in the association records. The notice must specify three things: (1) that a meeting will take place to discuss problems that may lead to the filing of a civil action; (2) the options, including civil actions, that are available to address the problems; and (3) the time and place of this meeting. To be in compliance with § 1368.5, the homeowners association must give this written notice to its members no later than 30 days prior to the association's filing of the civil action.

In the event the association has reason to believe the applicable statute of limitations will expire before the filing of the civil action, the association may file the action prior to notification, and then notify their members within 30 days after filing the action.

If you have any questions or concerns involving association procedures in filing or potentially filing a construction defect lawsuit, please contact us at (858) 625-3900 and ask to speak with Christina Ciceron, Esq.

## **Developer vs. Homeowners Association Arbitration Provisions**

Generally, an association is bound by Covenants, Conditions and Restrictions (CC&Rs). The CC&Rs are created by the developer of the common interest development. Recent case law however, has provided relief to associations such that it may not be bound by certain provisions in the CC&Rs.

In the case *Pinnacle Museum Tower Association v. Pinnacle Market Development*, the Association filed suit against the developer on behalf of its members for alleged construction defects to the common areas of the property. The developer claimed the action should be resolved through an arbitration hearing, rather than by jury trial, in accordance with the "arbitration clause" found in the CC&Rs. The Court held that the Association was not bound by the arbitration clause in the CC&Rs and had a right to a jury trial.

How did the Court come to this conclusion? In order for an association to be bound by a developer's restrictions in the CC&Rs, there must be an "actual agreement" between the parties. In the *Pinnacle* case, despite the existence of an arbitration clause in the CC&Rs, the Association could not be held to the terms because it had never agreed to the terms the developer drafted that waived the Association's right to trial by jury.

The Court also examined whether an arbitration clause waiving the right to a jury trial was unconscionable. An agreement can be unconscionable when: (1) there is inequality of bargaining power; (2) agreed upon terms are hidden within the document; and (3) a provision is unfairly one-sided. If any of these conditions are present, a provision of the CC&Rs may be unenforceable as was the case in *Pinnacle*.

If an association is considering litigation regarding developer related construction defects, it is important to review the CC&Rs for litigation procedures. Some procedures may be enforceable and some may not be enforceable. The only way to know is to get a legal opinion. Our firm will meet with you (manager and/or Board of Directors) at no cost and without obligation.

## **Retainer Contracts & Hourly Fee Agreements for Community Association Legal Services**

Silldorf & Levine offers a variety of general counsel legal service options for your association clients including hourly agreements and retainer contracts. We can draft a unique fee agreement to provide specialized legal needs for your association.

Our firm also represents homeowner associations in construction defect actions. We handle most construction defect matters on a contingency basis. If your association has a construction defect concern, we can provide a no cost evaluation for your association.

## **About Our Law Firm**

Silldorf & Levine, LLP is a full service community association law firm with offices in San Diego and Orange County. Our law practice serves all of Southern California. The attorneys at Silldorf & Levine, LLP have combined legal experience of more than 50 years. During that time, we have successfully represented hundreds of homeowners and community associations in a variety of legal matters.

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## **Free Consultation**

If you believe you or one of your homeowner association clients has a construction defect, our firm is available to help. Please contact our office at 1-800-811-5874 and ask to speak with Christina Ciceron, Esq.. We are available for a no cost/no obligation site inspection of the property. We also provide a no cost/no obligation follow-up inspection with an expert if warranted in the law firm's opinion. Please be advised that any expert needs to be retained by or under the direction of an attorney and not independently otherwise the information of the expert is not privileged or confidential. If you are a potential client with a potential construction defect that is approaching a statutory deadline, we can prepare a FREE Calderon or SB 800 Notice to stop the running of your statute of limitations. Please call us at 1-800-811-5874. We look forward to assisting you!