

HUDACK LAW

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Homeowners Association and the Business Judgment Rule

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On June 21, 2016, California Court of Appeal for the Fourth District, Division 1 handed down an interesting ruling with regards to Homeowners Associations (HOA) and the protection of directors under the Business Judgment Rule.

In **Palm Springs Villas II Homeowners Association, Inc. v. Parth**¹ Court of Appeal reversed a trial court ruling granting a motion for summary judgment to the defendant, a former member of the board of directors and president of the association. The defendant in the case moved for summary judgment on the basis that the business judgment rule protected her from liability for actions taken on behalf of the HOA, even if those actions were contrary to the governing documents.²

The Court of Appeal acknowledged that the business judgment rule applied to the HOA, a non-profit corporation, under California Corporations Code section 7231. However, the Court of Appeal held that the director needed to prove all the elements of section 7231(a). Section 7231(a) requires “[a] director shall perform the duties of a director, ..., 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.”³ The Court of Appeal stated that if the director complies with section 7231(a), then the director will have no liability for failure to discharge the obligations of a director.⁴

The business judgment rule “raises various issues of fact,” including whether “a director acted as an ordinarily prudent person under similar circumstances” and “made a reasonable inquiry as indicated by the circumstances.”⁵ “Such questions generally should be left to a trier of fact,” but can become questions of law “where the evidence establishes there is no controverted material fact.”⁶

In an earlier case, **Biren v. Equality Emergency Medical Group, Inc.**,⁷ that court held that the

¹ Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593

² Governing documents referred to in the case were the covenants, conditions and restrictions (CC&Rs) and the By-Laws of the non-profit corporation (aka the HOA).

³ **Palm Springs Villas II Homeowners Association, Inc. v. Parth**, Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9 (quoting Cal. Corp. Code § 7231, subd. (a)). See also **Ritter & Ritter, Inc. Pension & Profit Plan v. The Churchill Condominium Assn.**, 166 Cal. App. 4th 103, 123 (2008).

⁴ **Parth**, Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9

⁵ **Parth**, Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9 (quoting **Gaillard v. Natomas Co.**, 208 Cal. App. 3d 1250 (1989).).

⁶ **Parth**, Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9 (quoting **Gaillard**, 208 Cal. App. 3d at 1267–68.).

⁷ 102 Cal.App.4th 125 (2002)

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"director's violation of the governing documents did not render the business judgment rule inapplicable *under the circumstances*; namely, where the remainder of the business judgment rule requirements were satisfied."⁸

The Court of Appeal distinguished the Biren holding because in that case, the court found that all the other elements required for application of the business judgment rule and deference had been shown, whereas in the current case Parth had not.⁹ The Court of Appeal found that the trial court **erred in assuming** that the business judgment rule applied to actions in violation of the governing documents because "case law is clear that conduct contrary to governing documents may fall outside the business judgment rule."¹⁰ Here, the Court of Appeal found there was a triable issue of material fact as to the other elements of the business judgment rule which rendered the Biren holding inapplicable, at least at the current stage of the case (motion for summary judgment).¹¹

In addressing the defendant's actions that were in violation of the governing documents, the Court of Appeal explained that "[n]otwithstanding the deference to a director's business judgment, the rule does not immunize a director from liability in the case of his or her abdication of corporate responsibilities."¹² The Court of Appeal stated that "[w]hen courts say that they will not interfere in matters of business judgment, it is **presupposed** that judgment—reasonable diligence—has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment."¹³

About the author: L. Joseph Hudack has spent the last 28 years working in the Real Estate Industry doing transactional real estate for companies such as Walmart, Dial and Fluor Corporation. He has experience drafting, negotiating, executing and closing purchase and sale, lease and sublease, and lease terminations. In conjunction with general counsels, he has been responsible for the lease compliance and interpretation, property management, and budgeting for a portfolio of properties exceeding \$400 million in book value. In addition to his work for others, Mr. Hudack has owned and operated a real estate development and construction company; and consulted for nationally recognized companies such as Home Depot and Rubbermaid on their real estate needs. Mr. Hudack obtained the CCIM and MCR designations and is a licensed real estate broker in California. In 2015, Mr. Hudack completed his J. D. with Magna Cum Laude honors and is admitted to practice in California. Mr. Hudack has a passion for homeowner's association law and helping homeowner's with issues related to their homes. Mr. Hudack can be reached at Joseph@HudackLaw.com or through his website www.hudacklaw.com.

⁸ Id.

⁹ Parth, Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9

¹⁰ Parth, Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9; see, e.g., Nahrstedt v. Lakeside Village Condominium Assn., 8 Cal.4th 361, 374 (1994).

¹¹ Parth (Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9

¹² Parth (Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9 (quoting Gaillard, 208 Cal. App. 3d at 1263.).

¹³ Parth (Cal. Ct. App., June 21, 2016, No. D068731) 2016 WL 3437593, at *9 (quoting Burt v. Irvine Co., 237 Cal.App.2d 828, 852–53 (1965); see also Gaillard, 208 Cal. App. 3d at 1263–64.).