



HOA Homefront

The Business Judgment Rule, a Three Legged Stool (of Safety)

The Business Judgment Rule (hereafter, the “BJR” for brevity) is one of the most important things a good director should know well, because it protects directors from liability. However, well-meaning directors can accidentally stray outside of its protections.

The Rule - If operating under the BJR, a director is personally protected from liability. The BJR is found in Corporations Code 7231(a):

“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.”

It’s not that simple - Every day, volunteer directors needlessly and unknowingly leave themselves exposed to risk of personal liability by being outside the BJR. Know the elements of the BJR, and be protected as you do your best to help your association.

Good Faith - Good faith is not simply good intentions or a pure heart. Good faith is also not being in bad faith. The people who decide whether something is in good or bad faith are judges and jurors. So what is important is not what YOU think, but what someone else thinks of the action and the evidence about it.

Could someone claim a decision was based upon a desire to retaliate against “that member”? [You know, the one who always criticizes, complains, and

even abuses you?] The law requires that members are treated consistently, so horrible abusive members are entitled to the same roof repair as saintly, thankful members. Sometimes past statements or even e-mails can be taken out of context, with dangerous results. Make sure every statement you make in board meetings, and every e-mail, is carefully worded – and avoid intemperate or sarcastic remarks.

In Best Interests of Association - Of course, every action by a board should be in the association’s best interests, and every director thinks they are doing the best for their HOA. But a judge or jury would decide if your motivation was correct, by looking at your actions, your statements and the surrounding facts, and from that determine if you reasonably believed you were working for the HOA’s best interests (and not your own).

Avoid conflicts of interest. Avoid preferential treatment in remodels or repairs. Leave the meeting before the board discusses your home or building, and make sure the minutes reflect that fact.

Reasonable Inquiry - The board must have the appropriate qualified input before it makes a decision. A manager’s input may be all that is required, depending upon the size and complexity of the issue. However, if the matter is serious, large or complex, more expertise may be needed.

Well-meaning directors often innocently violate this requirement by either providing their own expertise (“I think that wall is structurally sound”) or by refusing to endorse the hiring of the appropriate consultant

("engineers are too expensive, can't we figure this out?")

A director's role is to make decisions based upon the information brought to the board. Make sure the board has sufficient and qualified input, appropriate to the decision. Sometimes the board must spend money to know it is right.

Three Legged Stool - The Business Judgment Rule is a three-legged stool. Lose one of the legs, and the result can be painful.

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