

A Recent Ruling Finds The California Court of Appeals Interpreting Board of Director Decisions

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Summer 1998 - Decisions made by a board of directors of homeowners associations are routinely questioned by association members. The "Business Judgment Rule" is commonly depended on by boards of directors to protect these decisions. However, the California Court of Appeals recent ruling, Lamden v. La Jolla Shores Condominium Association, 98 D.A.R. 3389, 98 C.D.O.S. 2475, (April, 1998, 4th Dist.) notes that some decisions should be measured by an objective standard of reasonableness rather than the business judgment rules. Lamden has been accepted for review by the California Supreme Court, and thus cannot be cited as precedent at this time. Nonetheless, it holds important lessons for Community Association managers.

Facts

In this case, a homeowner, Gertrude Lamden, owned a unit in the La Jolla Shores Club complex. For several years, Gertrude's unit had serious termite problems. She obtained a report saying that the building in which she lived should be tented and fumigated, and insisted that tenting and fumigating the three and four story buildings was the only way to solve the problem. The Association received a report which suggested either tenting/fumigating or spot treating should be done to alleviate the termites. The Association made a decision to spot treat because (1) the cost (about \$118,000 to fumigate the entire building), (2) the expense and hassle of relocating residents, (3) concerns about the effect of chemicals on the residents' health, (4) the fact that over \$1.5 million in exterior renovations to bridges and walkways (which would include replacement of damaged areas) was planned in the next two years, (5) potential claims for lost rental income, and finally, (6) the fact that tenting and fumigating may have provided only short term benefits because termites are endemic to the wooded coastal area where the project is located.

The homeowner sued in Superior Court. The Court held that the Association's action was reasonable under the business judgment rule. The business judgment rule is found in Corporation Code 7231 and requires the Board to act in good faith, and with the best interests of the Association in mind, and after reasonable inquiry. The Court found for the Association, and awarded the Association \$40,000 in attorney's fees'. The homeowner appealed.

Issue

Should the Association's action to spot treat for termites judged by the business judgment rule or under an objective standard of what is reasonable?

Holding

The Superior Court decision was reversed and Mrs. Lamden was granted a new trial because the appellate court found that the wrong standard was applied. The proper standard by which to judge the Association's action was the objective reasonableness

standard, and because it was "reasonably likely" that Mrs. Lamden would have prevailed if this standard were applied, the case was sent back to the trial court.

Reasoning

The Lamden case involves termites, which are lucky enough to have their own Davis-Stirling Act section, namely, section 1364. Section 1364 provides that a condominium association is responsible for repairing and maintaining common areas as occasioned by the presence of wood-destroying pests including termites and must promptly and effectively treat these pests.

Under the CC&Rs there was no question that "common areas" meant common areas as defined under the recorded condominium plan and included "bearing walls, columns, floors, roofs, foundations..."

The court relied on Francis T v. Village Owners Assn., (1986) 42 Cal.3d 490, the California Supreme Court case which distinguished between the Associations' duties to its members under the governing documents and common law principle of ordinary care not to injure a third party. Remember Frances T., the case where the California Supreme Court found a condominium association liable to a resident who was assaulted after her request for security lighting was denied? There, the court found a "dual relationship." The association's directors were, of course, fiduciaries, and the business judgment rule might apply to the Board/member relationship, but the Association also was found to have a common law relationship with a resident, similar to a "landlord." Because our friend Gertrude's lawyer alleged that the Board breached its duty to the "tenant" Gertrude, the general landlord duty to exercise reasonable care applied, the Appellate Court found.

Why is this decision so significant? Because while the trial court said, "We won't second guess the Board's good faith decision," the Appellate Court said, "Yes. we will!" The justices put on their "20-20 hindsight" glasses and said there was evidence that the program of spot treatment was only a "partial solution," and that under an "objective standard" (that is, what the justices or the judge or the jury things a reasonable director would do in similar circumstances) it was "reasonably likely an outcome more favorable to Lamden would have resulted." The case was sent back to the trial court for the judge to try his hand at second guessing.

We will now wait and see how the California Supreme Court views this issue. For now, be aware and follow these Practice Pointers, and always ask yourself, is there a Gertrude in your association, waiting to challenge the Board's decisions?

The Law Journal Guest Editor, David Feingold, Esq. recommends these practice pointers be followed when dealing with controversial maintenance issues:

Practice Pointers

1. Document significant maintenance or repair decisions in a formal resolution, setting forth the information relied on by the Board and the rationale for its decision.
2. Rely on experts and seek second opinions.

3. If a special assessment is required to fund repairs demanded by an owner, put it to a vote of the membership as a funding issue.
4. Treat every owner's request seriously.
5. Involve the owners, through committees, in evaluating courses of action for controversial maintenance or repair issues.