The Common Interest Law Report

What Does It Mean For A Board Member To Be A Fiduciary?

by Jan Kopczynski

Most board members for community associations understand that they owe a "fiduciary duty" to the homeowner members of their association. But what exactly does it mean, as a practical matter, for a board member to have a fiduciary duty to its homeowner members?

For many years now, it has been well-established that homeowners associations have a fiduciary relationship with their members. But as we know, a homeowners association is, in most cases, a non-profit corporation - not an actual person - and therefore it must act through its board of directors just like any corporation must. As such, the law states that the individual board members themselves, of any corporation, non-profit or otherwise, owe their shareholders (or members, in the case of community associations) a special duty to ensure that the affairs of the corporation are managed in the best interest of the members. The failure of a board of directors to adhere to this heightened standard of care and loyalty can, an often does, result in serious liability to the corporation for failing to comply with this duty.

Statutory Rules

But how does this fiduciary-duty concept play itself out in real world? For example, most board members for community associations recognize that they have an obligation - a legal duty - to disclose to the association members that a lawsuit may be filed against the association's developer for construction defects. Specifically, the California Legislature has imposed upon homeowners associations the duty of giving their members written notice of intended litigation regarding construction defects. See Civil Code section 1368.5.

A Case on Point

Fair enough, but let's consider another scenario. For example, does a homeowners association, through its board of directors, have a fiduciary duty to notify its members that it has filed a lawsuit against a third party - a lawsuit that has nothing to do with construction defects? This question was squarely addressed by the California Court of Appeal in a case known as Ostayan v. Nordhoff Townhomes Homeowners Assn., 110 Cal. App. 4th 120 (July 2003).

The circumstances that gave rise to that case took place in 1997 when the plaintiff, Mr. Ostayan, purchased an uninhabitable condominium for the sum of $25,000 in the North Hills of Los Angeles; the condominium had been damaged by the 1994 Northridge earthquake. As a result of that purchase, Mr. Ostayan became a dues-paying member of the Nordhoff Townhomes Association.

During the period Mr. Ostayan owned his condominium, the association was involved in a dispute with its insurance carrier over coverage arising out of the 1994 earthquake. The dispute with the carrier was the frequent subject of discussion at meetings of the association's board of directors, and, in fact, the association had sent its members three written notices about the dispute during the time Mr. Ostayan owned his unit.

After negotiations with the insurance carrier broke down, the association filed a bad-faith lawsuit against the carrier while Mr. Ostayan owned his unit. But the association did not inform its members of the litigation until a week after Mr. Ostayan had sold his unit to a third party for $53,000. As it turned out, in 2002 the association ended up settling its lawsuit against its insurance carrier for $20 million, and each unit owner received $180,000 of the settlement.

Mr. Ostayan, believing he was entitled to some of the settlement proceeds, filed suit against the association alleging breach of fiduciary duty based on the theory that the association owed him a duty of notification with respect to the association's lawsuit against its insurer. The implication of the lawsuit was that, had the board timely informed Mr. Ostayan that it was suing the association's insurance carrier for failing to

provide funds to repair the condominums, Mr. Ostayan would have waited until the conclusion of the lawsuit before selling his unit. But, instead, he sold his unit for a small gain, and in doing so he failed to reap the benefit of the $180,000-per-unit settlement with the insurance carrier. In effect, Mr. Ostayan lost out on an additional $127,000.

The Ruling

But the trial court disagreed with Mr. Ostayan and found in favor of the association, finding that the association owed no such duty to the plaintiff. Notably, the Court of Appeal agreed and affirmed the summary judgment in favor of the association. The Court of Appeal ruled that the association did not have a fiduciary duty to notify Mr. Ostayan (or its others members, for that matter) that it had filed a bad-faith lawsuit against its insurer where the governing statutes and the association's governing documents did not require such notification. In other words, the court ruled that filing the action was within the scope of the association's inherent authority. And even if the association had such a duty of notification, it satisfied that duty in this case by disclosing its dispute with the insurer in three separate written communications to its members, which included plaintiff at the time.

Conclusions

From this one case, board members can learn several valuable points:

First, there is no doubt that a homeowners association, acting through its board members, has a fiduciary relationship with its members.

Second, the primary governing document of a homeowners association is the declaration of covenants, conditions, and restrictions (CC&Rs) - the document that contains a legal description of the development and "the restrictions on the use or enjoyment of any portion of the common interest development that are intended to be enforceable equitable servitudes." See Civil Code section 1353(a).

Third, in addition to the governing documents, homeowners associations are governed by statute. The statutory duties of homeowners associations are set forth in the Davis-

Sterling Common Interest Development Act (Civil Code section 1350 et seq.) and the Nonprofit Mutual Benefit Corporation Law (Corp. Code section 7110 et seq.).

And, finally, the Nordhoff opinion is another in a growing line of appellate opinions that affirms the power of a community-association board to exercise discretion and sound business judgment in its affairs with its members and third parties. See also Lambden v. La Jolla Shores Homeowners Assn., 21 Cal. 4th 249 (1999) and Nahrstedt v. Lakeside Village Condominium Assn., 8 Cal 4th 361 (1994).

That said, and despite the favorable holding of this opinion in favor of community-association boards of directors, the safest course of action for board members is to keep your members reasonably informed about all litigation against third parties - even though such notice may not be required under the association's CC&Rs or the statutes in effect at the time. Doing so provides the board with powerful evidence in a later dispute with a member that the board met its fiduciary responsibilities.

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