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KEEPING FAITH: FIDUCIARY OBLIGATIONS IN PROPERTY OWNERS ASSOCIATIONS

Robert G. Natelson*

INTRODUCTION

The most significant challenge to American real property law in this century has been the rise of the residential property owners association. Although such associations were comparative rarities only twenty-five years ago, they now regulate the ownership rights of millions of home owners. Indeed, it has been projected that within fifteen years one out of every two Americans will be subject to an association regime.¹

Given the magnitude of this development, the amount of serious scholarship produced in the area has been surprisingly small, and its quality has not always been good.² Thus the courts and

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2. Most legal publications in the planned community field are practice guides. See, e.g., W. Hyatt, CONDOMINIUM and HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW (1981); W. Hyatt, CONDOMINIUMS AND HOME OWNER ASSOCIATIONS: A GUIDE TO THE DEVELOPMENT PROCESS (1985); ALI-ABA, REAL ESTATE CONDOMINIUMS AND PLANNED UNIT DEVELOPMENTS (1974); ALI-ABA, CONDOMINIUM, PLANNED UNIT DEVELOPMENT, AND CONVERSION DOCUMENTS (1985); Natelson, Avoiding Perpetuities Problems in Condo Declarations, 13 COLO. LAW. 2229 (1984); Pearlstein, Developer Liability for Defects in Condominiums, 74 ILL. B.J. 18 (1985). The most important treatise is P. Rohan & M. Reskin, CONDOMINIUM LAW & PRACTICE (1965) (regularly supplemented) [hereinafter P. Rohan]. Much of this multi-volume work is composed of forms. As will appear from the notes, infra, the bulk of the law review literature has consisted of student notes. A significant exception is Hyatt & Rhoads, Concepts of Liability in the Development and Administration of Condominium
legislatures have had to face the inevitable problems almost unaided. It is hoped that this study will provide the courts and legislatures with some welcome assistance.

The theme of this article is _official responsibility_—the obligations of association officials toward the entity they represent and, directly or indirectly, the members they serve. The specific aspects chosen for analysis are two: (1) the applicable standard of care to be expected from association directors and officers, and (2) the “fiduciary” obligations of developers. Although many other facets of official responsibility are in need of detailed treatment, the two mentioned have proven to be quite enough for an article of this size.


3. This is probably a better term than _fiduciary responsibility_, because, strictly speaking, “fiduciary” duties are limited to the duty of loyalty and the responsibilities fairly inferable from the duty of loyalty. Thus, the obligation to avoid conflicts of interest and the obligation to preserve trade secrets are technically “fiduciary” in nature, while the duty of reasonable care is not. See H. Henn & J. Alexander, _Laws of Corporations_ § 231, at 611-12 (3d ed. 1983) [hereinafter H. Henn]. However, it is quite common to add the duties of reasonable care and good faith to the list of “fiduciary” duties, and often this is encouraged by applicable statutes. See, e.g., _Frances T._, __ Cal. 3d at ___, 723 P.2d at 587, 229 Cal. Rptr. at 470 (citations omitted).

It is in recognition of the popularity of this broader use of the phrase “fiduciary duty” that the title of this article has been selected. However, the broader use can be very misleading, even to otherwise competent lawyers and legislators, and, for that reason, should probably be abandoned. Examples of such confusion are examined in Part III of this article.

4. Those interested in exploring this area further have many opportunities. Studies are needed on the following questions, _inter alia_: (1) Should the obligations of officials of on-going associations extend only to the entities themselves or to the individual members as well? (2) If some should run to the individual members, which obligations should so run and to what extent? (3) What should be the preferred procedural devices (class actions, individual actions, derivative actions, etc.) for pursuing claims based on breach of duty? (4) To what extent, if at all, should the standards of official liability differ when an injured tort plaintiff is (a) a member, or (b) a non-member of the association? (5) What specific steps ought to be taken and/or what formulae ought to be applied in considering such specific association actions as (a) adopting a rule regulating leasing or pets, (b) setting a level of reserve funds, or (c) hiring a major contractor?
The treatment of property owners associations in this article is unified. That is to say, the content is applicable to all mandatory associations, and is not limited (as writings in this field so often are) to any one type, such as the condominium association or the cooperative housing corporation. This is because, as will appear below, the principles of official responsibility governing all residential property owners associations are the same. Thus, for our purposes the ownership structure of the property governed is of little importance. On the other hand, the reader should be cautioned against applying the conclusions expressed herein beyond the realm of property owners association law, for, as will be seen, the purposes and requirements of these associations are quite different from those of other entities, such as the business corporation, to which they have been (often too readily) compared.

I. Context of Issues of Official Duty

A. The Functions of the Property Owners Association

In common usage, of course, the phrase "property owners association" is frequently employed to denote certain voluntary civic lobbying organizations. However, this article focuses exclusively on the kind of association (1) which governs the use of a specific tract (or tracts) of real estate (herein called the "planned community"), (2) which is established by corporate documents (in the case of a cooperative) or covenants running with the land (in the case of a subdivision), and (3) in which membership is, by the terms of the organizing documents, required as a condition of property ownership in the tract. Such associations are generally managed by an elected board of directors, may be incorporated or unincorporated, and are granted the power, by the terms of their organizing

5. The term "planned community" is used herein to refer to all four types of association properties discussed—cooperatives, single-family home owner subdivisions, condominiums, and hybrids. Cf. UNIF. COMMON INTEREST OWNERSHIP ACT § 1-103(23), 7 U.L.A. 242 (1985) and UNIF. PLANNED COMMUNITY ACT § 1-103 (21), 7B U.L.A. 15 (1985) (excluding condominiums and cooperatives from the definition of "planned community"). However, the U.C.I.O.A. has been adopted only in Connecticut and Alaska, and the U.P.C.A. has not been adopted by any state.

For planned communities which are not cooperatives, but which contain a significant amount of common interests, the author is increasingly inclined toward a more technical phrase of his own coinage: Interdependent Covenanted Subdivision (ICS).

6. See, e.g., UNIF. CONDOMINIUM ACT § 3-103, 7 U.L.A. 504-05 (1985) ("executive board").

documents, to impose mandatory assessments upon members and upon their property interests.  

While the functions of no two associations are precisely alike, broad generalizations can be made. Most associations are charged with responsibility for maintaining those parts of the planned community set aside for common use ("common properties"), and are given rule-making authority over all or part of the community. In addition, the association frequently has other responsibilities, such as providing security for the complex, regulating the sale and/or rental of units, administering building restrictions, and organizing social events.

Residential property owners associations are employed in four kinds of real estate developments: (1) subdivisions of separately-owned single-family homes, (2) housing cooperatives, (3) condominiums, and (4) subdivisions of attached and semi-attached housing whose ownership formulae differ from that of a condominium. The term "hybrid communities" will be used to denominate this last group.  

B. The Traditional Associations

Associations governing subdivisions of single-family homes made their first appearance in the United States during the nineteenth century, and they have been reasonably common for several decades. Despite this fact, the quantity of reported litigation arising out of these associations has been rather small, and almost none of it deals with questions of official duty. From the point of view of the researcher, this is unfortunate because reported cases


11. Id. at 18.

provided a valuable source of data on association management problems. The absence of litigation may be due to the high degree of member satisfaction reported by the authors of one published study.\(^{13}\) A more likely explanation, however, is that the responsibilities and financial significance of such associations have traditionally been minimal.\(^{14}\) Thus, even in the event of a dispute, any results which might be attained through litigation are simply not worth the cost.\(^{15}\)

The other traditional association, the cooperative housing corporation, also dates back many years.\(^{16}\) A cooperative housing corporation is the record owner and legal manager of the building subject to its regime, and the building's tenants are its shareholders.\(^{17}\) Thus association responsibilities are substantial, and there has been, accordingly, a respectable amount of litigation involving these organizations. The reported cases included several on fiduciary duty issues.\(^{18}\)

C. The Newer Associations: Condominiums and Hybrids

The current importance of association official responsibility issues is due chiefly to the recent explosive growth in the number of communities in the condominium and "hybrid" categories.\(^{19}\) In every state, condominium ownership is closely defined by statute,

13. **Handbook, supra** note 10, at 15. This study had some design flaws. For example, of 247 communities surveyed, in 229 only individuals in power (officers or developers) were interviewed. In only eighteen (seven percent) were ordinary members without positions of responsibility interviewed. Id. at 15. One would, of course, expect a more favorable view from those who manage affairs than those who do not. Additionally, the survey did not include interviews with owners of cooperative or condominium units, who generally pay far higher assessments to their association than do single-family homeowners, and are impacted by it to a much greater extent.

14. Id. at 39-113, and *passim*.

15. The single-family homes associations survey cited supra found no community with assessments in excess of $110 *per year*, with seventy-one percent at $30 or less *per year* (1962 dollars). Id. at 20-22. Assessments in condominium, hybrid, and cooperative associations are often well over $100 *per month*.


19. The number of condominiums has now far Outpaced the number of cooperatives, for example. R. Natelson, *supra* note 2, at 18.
and each applicable statute spells out the formula necessary for a housing development to qualify as a condominium within that state. These formulae differ surprisingly little. They provide for each homeowner to hold title to a three-dimensional block of air space, which block of air space is usually (but, in some states, need not be) limited to the confines of a building. The applicable statutes also specify that appurtenant to air-space ownership, and inseparable from it, is a fixed percentage interest in all parts of the condominium outside the individually owned blocks of air space. These co-owned portions of the complex are denominated "common elements" or "general common elements." Common elements include the structural members of each building (floors, walls, roofs), facilities within the air space blocks utilized by more than one unit owner (e.g., common pipes), and the grounds, recreational facilities, and other exterior portions of the complex. Although a condominium association may own real property in its own name, it does not own the common elements; it merely ad-


23. For a non-technical introduction, see R. Nateelson, supra note 2, at 15-22.

24. This is specifically or impliedly authorized in some condominium statutes. See, e.g., Ill. Ann. Stat., Ch. 30, §§ 318.3, 318.4(g), (k) (West Supp. 1986); Unif. Condominium Act § 3-102(a)(8), 7 U.L.A. 502 (1985). But see Towerhouse Condominium, Inc. v. Millman, 475 So. 2d 674 (Fla. 1985) (holding that statutory authorization to acquire condominium units did not include authorization to hold title to other realty). For an example of a condominium declaration in which association ownership of property is authorized, see 1B P. Rohan, supra note 2, at App.-148 (1983).

One of the condominium associations for which the author served as corporate counsel, while he was in private practice, held the deeds to certain recreation areas (clubhouse, tennis courts, swimming pools, etc.). However, most of the community's grounds were co-owned
ministers them. Nonetheless, the financial result is nearly the same as it would have been had the association owned them.\textsuperscript{25}

From the foregoing, it can readily be seen that administration of the common elements is the major responsibility of the condominium association. Since management of the common elements requires significant amounts of money, and since that money usually (although not invariably)\textsuperscript{26} is routed through the association, individual owners have a large stake in association decision-making. For this reason, the condominium, despite its novelty in this country,\textsuperscript{27} is already responsible for more reported litigation than any of the other three community types.\textsuperscript{28} As will appear below, the reported condominium cases have included a number of legal battles waged on issues of official duty.

Also responsible for a significant amount of litigation are the hybrid communities. Like condominiums, hybrids feature extensive common property and organizational documents which contemplate a high degree of interdependence among unit owners. Developers give hybrids a variety of names—"town homes," "cluster homes," "patio homes," and "atrium homes"—all more descriptive of their architectural styles than of the legal relationships which govern them.\textsuperscript{29}

\begin{footnotes}

\footnotemark{25} One difference has to do with real property taxes: Since the title owner usually pays real property tax, in a condominium the individual owners, rather than the association, will generally bear that expense. \textit{But see} COLO. REV. STAT. § 39-1-103 (10) (1986 Supp.) (taxing association property pro rata to unit owners, rather than to the association).

\footnotemark{26} The most frequent exceptions are for the limited common elements, maintenance responsibility for which is occasionally in the owner of the unit to which they are appurtenant. \textit{See, e.g.,} CONDOMINIUM DECLARATION, COTTONWOOD VILLAS (Adams County, Colorado) § 17(a)(3) (air conditioning units). A declaration amendment altering maintenance responsibilities was at issue in Hillsboro Light Towers, Inc. v. Sherrill, 474 So. 2d 1219 (Fla. Dist. Ct. App. 1985). \textit{See also} UNIF. CONDOMINIUM ACT § 2-108 comment 1, 7 U.L.A. 470 (1985).

\footnotemark{27} The first American jurisdiction to adopt a condominium statute was Puerto Rico (1951). However, no state enacted legislation until the 1960's.

\footnotemark{28} There have been numerous attempts, in both legal and popular literature, to attribute the origin of the condominium to ancient Rome. \textit{See, e.g.,} R. CUNNINGHAM, W. STOEBUCK & D. WHITMAN, \textsc{The Law of Property} 37, n.19 (1984); B. HARWOOD, \textsc{Real Estate Principles} 485 (1986); H. ROTHEMBERG, \textit{supra} note 2, at 9. This is without a doubt an error.

\footnotemark{29} However, the story of how the notion of "Roman origin" crept into American legal scholarship is a tale both instructive and amusing. It is told in this author's forthcoming \textit{Comments on the Historiography of Condominium: The Myth of Roman Origin}, 12 OKLA. CITY U. L. REV. _____ (1987), which also summarizes the actual history of the institution.

\footnotemark{28} As will become apparent, most of the court decisions discussed \textit{infra} are condominium cases.

\footnotemark{29} Communities containing any of these styles of architecture may, of course, be held
\end{footnotes}
Common to all hybrids is the fact that their ownership structure does not comply with the locally applicable condominium act. Beyond that point, generalizations about their ownership structure are difficult to make, because there are great differences among them. One widely adopted scheme is to grant to each individual purchaser full vertical ownership (i.e., including air space above and ground beneath) of the lot on which his (usually attached) home is situate, while deeding to the association ownership of all parts of the planned community not encompassed by individually owned lots. Numerous other ownership splits are encountered. Moreover, the division of maintenance responsibility in hybrid communities may deviate significantly from the division of formal property ownership. The dividing lines between individual and common maintenance in each community, like those between individual and common ownership, can be determined only by consulting its operative documents.

D. The Officials of the Property Owners Association

A developer planning any of these four kinds of complexes is required, by law or by good practice, to institute an association in condominium ownership, while some (particularly townhouse developments) may be platted so as to avoid a property owner's association or any co-owned property except party walls. In the author's experience, however, many real estate sales people and prospective purchasers—and even some lawyers—are under the impression that architectural style somehow determines legal ownership structure.


31. Examples are those found in Del Mar Beach Club Owner's Ass'n, Inc. v. Imperial Contracting Co., Inc., 123 Cal. App. 3d 898, 176 Cal. Rptr. 886 (1981) (association owned all of complex except for individual air space units) and in COVENANTS, MAGNA CARTA TOWNHOMES (Denver County, Colorado) (entire complex divided among unit owners with extensive "common easements"). See also Prefatory Note, UNIF. PLANNED COMMUNITY ACT, 7B U.L.A. 1 (1985).

32. For example, it is common for the association to have maintenance responsibility over the (privately owned) exteriors of units. See, e.g., DECLARATION OF COVENANTS, YORKTOWN HOMES ASSOCIATION (filed for record at Book 1917, Page 878 Adams County, Colorado), art. vi, § 1, at 886.
rather early.\textsuperscript{33} This is usually done by filing an organizational doc-
ument (i.e., its articles of incorporation or articles of association) when the community's covenants or condominium declaration is filed. Almost always, establishment is completed before the closing of title on the first unit sold. At that point, the association be-
comes legally responsible for the maintenance of the common properties. As a matter of practice, however, the developer often retains much of the maintenance burden throughout his sales campaign.

Because an association requires a government, the developer must select individuals to staff its board of directors and to serve as its officers (who are usually elected by the board). If few units have been sold, there may not be enough property owners available for this purpose. Additionally, those property owners who are available may not be willing to undertake leadership positions, or may be ill-suited for the task. Since the developer's sales campaign depends upon well-managed common areas and a cooperative board of directors, it is in his interest to ensure that he remains in control of the association during this period. Indeed, developer control in the early years is almost universally recommended by planned community experts,\textsuperscript{34} both as a way of protecting the de-
veloper's investment and as a method of training the new owners in association management.

Throughout an initial period of months or years, therefore, a majority of the association board of directors and most (or all) of its officers are nominees of the development company. Typical developer nominees include the principals of the company, their spouses, the resident manager and/or sales agent, and the corpo-
rate attorney. Over time, unit-purchaser participation in associa-
tion affairs expands. Eventually, the developer's sales campaign comes to an end, and the purchasers fill all association positions.

The legal standards governing association officials are there-
fore relevant in evaluating the conduct of four classes of people: (1) unit purchasers who have been elected to association office, (2) the development company in its role as “corporate promoter,” (3) the

\begin{itemize}
  \item[33.] Written discussions of the development process in these communities abound. See, \textit{e.g.}, W. Hyatt, Condominiums and Home Owner Associations: A Guide to the Develop-
ment Process, supra note 2.
  \item[34.] See, \textit{e.g.}, Handbook, supra note 10, at xii, 4, 24, and 233 ff; 1 P. Rohan, supra note 2, § 17A.02(4); Rose, Nonprofit “Resident” Association Trends, in Trends in Nonprofit Organization Law 87, 89 (1977).
\end{itemize}
development company in its role as "controlling shareholder" during its sales campaign, and (4) the nominees of the developer who hold positions in the association. The ensuing parts of this article will examine specific issues surrounding the obligations of officials in each of these classes. Beyond its scope are the duties of hired agents such as professional management companies.

E. Previous Treatment of Official Duties in Property Owners Associations

Most of the law governing the conduct of association officials has been developed by the courts. Reasoning by analogy from principles applicable to business enterprises and non-profit foundations, the judges have imposed the usual duties of due care and good faith. They have held that association officials have an obligation to follow the bylaws and other rules of their complexes, to keep adequate records, to exercise appropriate supervision over the affairs of the association and the community, to maintain capital reserves, and to notify members or prospective members of certain matters. They have applied the usual prohibitions on self-dealing and have emitted the customary exhortations to loyalty. Furthermore, the judges have recognized some of the common defenses to liability, especially the Business Judgment Rule.
Although dealing with a new unfamiliar subject, the common law reasoning of the courts has generally served them well. Yet many of their pronouncements have led to confusion because their language has not always been precise. Moreover, the legislators drafting statutes in the area have tended to borrow the words in judicial opinions without adequate consideration of the contexts in which they were uttered. Those words have thus been applied in ways both inappropriate and overbroad. As will be seen in Part IV, some of the commentators have confused matters further—at times misunderstanding the issues involved, and at other times serving extraneous political purposes of their own.

F. Overview of Analysis in Parts II Through IV

The facets of official duty selected for analysis in Parts II, III, and IV were chosen both for their inherent importance and for the degree of confusion which has hitherto attended them. Three questions have been identified for examination, the first two relevant to all association officials and the last applicable specifically to the nominees of developers. They are as follows:

(1) Are association officials to be held to a “reasonable care” standard or, as unpaid, part-time volunteers, to something less? (Part II)

(2) Should the Business Judgment Rule be employed to reduce the applicable standard of care within the usual scope of that rule? (Part III)

(3) To what extent should fiduciary obligations be imposed upon the developer and his nominees? (Part IV)

For reasons that will become apparent, this author has concluded, first, that a general standard of reasonable care is appropriate in reviewing all actions of association officials; second, that while some of the lore surrounding the Business Judgment Rule is useful in defining the duty owed by association officials, the Rule itself is irrelevant to property owners associations and should be

A.2d 280; Schwartzmann, 33 Wash. App. 397, 655 P.2d 1177. Some of the cases cited in this note and in notes 35-43 supra are thumbnailed in Rosenberry, supra note 1.

disregarded; and, third, that while developer nominees owe to the association the same duties of good faith, reasonable care, and contractual compliance as to any other officials, it is improper to conceive of their obligations as “fiduciary” in the strict sense of the word.

II. THE STANDARD OF CARE: SHOULD IT BE RELAXED FOR ASSOCIATION OFFICIALS?

A. The “Reasonable Care” Rule

There seems to be general agreement that directors and officers of property owners associations have an obligation of due care, ordinary care, or reasonable care analogous to that imposed upon their counterparts in business enterprises.46 For the most part, the actual measure applied in the reported cases and by the applicable statutes has been similar to that imposed upon businessmen.47 However, this consistency has not been universal. A few

46. The “due care” standard and standards comparable to it are applied to business officials in the majority of American jurisdictions. See American Law Institute, Principles of Corporate Governance: Analysis and Recommendations 29-43 (Tent. Draft No. 4, 1985) [hereinafter ALI].

A recent pronouncement of the California Supreme Court, Frances T., —, 229 Cal. Rptr. 456, 723 P.2d 573, distinguishes between tort liability to a shareholder qua shareholder (arising out of the breach of a director's duty to the entity he serves) and liability to a shareholder qua third party (e.g., personal injury arising from negligence). This author is not fully convinced of the validity of the distinction, which seems to be based in part on the California statutory scheme, and on a misguided attempt to accommodate the Business Judgment Rule (see infra Part III). To the extent that such a distinction is valid, this article focuses upon the former sort of liability.

47. In accordance with proper English usage, the masculine form as employed herein serves as the form of indefinite gender where the context so requires.

Cases applying a “reasonable care” standard in association settings are numerous. In many of these, the review results from a challenge to an association rule or bylaw. See, e.g., Hidden Harbour Estates, Inc. v. Norman, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975); Amoruso v. Board of Managers of Westchester Hills Condominium, 38 A.D.2d 845, 330 N.Y.S.2d 107 (1972); Forest Park Coop., Inc. v. Hellman, 2 Misc. 2d 183, 152 N.Y.S.2d 685 (Sup. Ct. Queens Co. 1956); Holleman v. Mission Trace Homeowners Ass'n, 556 S.W.2d 632 (Tex. Civ. App. 1977). However, the courts have extended the rule of reasonable discretion beyond mere rule-making. Ryan v. Baptiste, 565 S.W.2d 196 (Mo. Ct. App. 1978) (relying on three rule-making cases to uphold reasonableness of board's order forcing owners to remove locks); Schmeck, 441 So. 2d 1092 (reasonableness of board's response to water problems upheld). The “rule of reason” governs board conduct in Uniform Condominium Act states, Unif. Condominium Act § 3-103(a), 7 U.L.A. 504 (1985), and is also a part of many non-profit corporation statutes. See, e.g., N.Y. Not-For-Profit Corp. Law § 717 (McKinney Supp. 1986). None of these statutes or cases draws a distinction between business and association standards. Cf. N.Y. Bus. Corp. Law § 717 (McKinney Supp. 1986) (initial wording almost identical with Not-For-Profit provision).
cases and commentators have expressed some uneasiness with the business standard, and have suggested that association officials may owe something less to the people they represent than do the executives of business corporations. The usual reason given for this conclusion is that association directors and officers are commonly part-time, unpaid volunteers. For example, in his treatise on non-profit corporations, Professor Oleck acknowledges the theoretical applicability of the due care rule, but adds:

If a director is to serve as such in a full-time capacity, he is held to the standard applicable to a man who is running his own business. This high standard seldom applies in non-profit corporations, where directors usually are part-time voluntary servants, deriving no pecuniary benefits from their work.

Comparable sentiments have been expressed by a New York Supreme Court justice. Kleinman v. High Point of Hartsdale I Condominium was a suit by unit owners against their condominium board of managers for alleged negligence in failing to make repairs. The plaintiffs sought to impose personal liability upon the defendants, but were faced with an excusalatory provision in the community's organizational documents. This provision limited director liability to willful misconduct and bad faith. In accordance with the great weight of authority, the court upheld the exculpatory clause. Instead of relying merely upon that authority, however——

48. This appears to be true in nearly all associations. A typical provision denying compensation to directors is found in 1B P. ROHAN, supra note 2, at App. 192.28 (182-83) (bylaws providing that "[n]o compensation shall be paid to the President or the Vice-President or any Director . . . for acting as such Officer or Director"). In view of the magnitude of their responsibilities, there is little, if any, justification for denying association directors and officers compensation for their work.


50. 108 Misc. 2d 581, 438 N.Y.S.2d 47 (Sup. Ct. Westchester Co. 1979). Closely aligned with commentaries such as Professor Oleck's and cases such as Kleinman are suggestions that directors nominated by the developer have a higher duty to the home owners than do the owners' own representatives. See, e.g., Troy v. Village Green Condominium Project, 149 Cal. App. 2d 135, 145-47, 196 Cal. Rptr. 680, 686-87 (1983), aff'd sub nom. Frances T., Cal. 3d ___ 723 P.2d 573, 229 Cal. Rptr. 456 (1986) (holding that negligence by a homeowner director is not a breach of fiduciary duty, as well, despite a previous holding that negligence by a developer-director was a breach of fiduciary duty). This case may be justified, however, as a better understanding of the scope of duties truly fiduciary (i.e., arising out of the duty of loyalty) as opposed to those imposed for other reasons (i.e., due care, good faith). See also UNIF. CONDOMINIUM ACT § 3-103(a), 7 U.L.A. 504 (1985), imposing ordinary care obligations on home owner representatives but "fiduciary" obligations on developer nominees. As demonstrated in Part IV, infra, this conclusion is perverse.

51. To the extent such clauses provide relief from liability for ordinary negligence (as opposed to more culpable conduct), they are generally upheld even as to trustees. G.G. Bo-
ever, the judge chose to enunciate some policy reasons for his decision. Included in his decision was this troublesome sentence: "This type of gratuitous quasi-public service should be encouraged by exoneration from personal liability rather than be discouraged by imposition of personal and individual liability."\textsuperscript{52}

The judge deciding \textit{Kleinman} did not offer any suggestion as to what, in absence of an exculpatory clause, the burden of care for association officials should be. Is the voluntary nature of service to result in liability only for conduct more culpable than negligence? Or is volunteerism but one factor to take into account in determining whether due care standards have been met?

The elements of part-time service and volunteerism would not seem to justify adopting a standard lower than the reasonable care rule. Neither the part-time nature of the work, nor its lack of compensation, is unique to associations or other non-profit organizations. Both elements are characteristic of many business directorships. Indeed, most directors of business corporations serve part-time—sometimes on a more occasional basis than would be wise for association officials.\textsuperscript{53} The courts have long recognized that while the amount of knowledge held by "outside" directors will be less than that possessed by "insiders," each director must still exercise the degree of care appropriate in his circumstances.\textsuperscript{54} Furthermore, many business directors serve for no pay or for nominal pay. It has been, in fact, the traditional expectation that they do so. Nevertheless, they remain subject to the reasonable care rule, although the courts hold that compensation is one factor to consider in determining whether that standard has been met.\textsuperscript{55}

\textsuperscript{52} GERT & G.T. BOGERT, LAW OF TRUSTS 339, 341 (1973). Trustees are usually held to a higher standard than corporate directors. H. OLECK, \textit{supra} note 49, at 477. Another case upholding such a clause in a condominium setting is Kelley v. Astor Investors, 106 Ill. 2d 505, 478 N.E.2d 1346 (1985). Such clauses are not uncommon (see, e.g., 1B P. ROHAN, \textit{supra} note 2, Appendix C-4, at App. 216.39), but as the text of this article would imply, this writer has doubts about their wisdom.


\textsuperscript{54} \textit{Id.} See also H. HENN, \textit{supra} note 3, § 237, at 623.

\textsuperscript{55} H. HENN, \textit{supra} note 3, § 244, at 664-66 (traditional rule that directors are not compensated); § 234, at 623 (compensation is a permissible factor in determining if director had exercised reasonable care, but not lowering the reasonable care standard itself). As will shortly appear, the motivations of association directors in seeking office are often no more altruistic than those of business directors. \textit{See infra} text following note 61.
If it be conceded that "reasonable care" is the appropriate measure of the conduct of association officials, there remains the question of how indulgently it should be applied. Here the lesson of recent experience is clear: not very indulgently at all.

B. Recent Experience and the Standard of Care

Because the individual units in most of the newer planned communities are highly interdependent, association conduct has a substantial, in truth overwhelming, influence upon the value of those units. Good association management can add significant value (both financial and non-financial) to the homes it governs. Unscrupulous or careless management can cause enormous suffering and loss.

Indeed, individual owners in a misgoverned planned community are more likely to incur significant personal damage than are most individual shareholders of a poorly run profit corporation. For one thing, their investment is greater. For most people, a home is the largest investment they will ever make. Beyond its financial value, moreover, a dwelling unit has a unique value, both as a home and as an identifiable piece of real estate. Association misgovernment can do more than depress the sales price of a unit; it can make living there personally uncomfortable and/or personally dangerous, and it can make the property virtually unsalable.

The unique kind of torture that can be inflicted by poor management is an aspect of association living that has received insufficient attention in the press and from scholarly commentators. While in law practice, this writer became aware that poor management, and the suffering it brings, is now a fact of life in many planned communities. Poor management may be the result of malice or of ignorance or of negligence. To those who have borne the results, the causes can matter little. Suffice it to say that human suffering may be inflicted in numerous ways: as a result of insufficient safety and security measures, failure of association officials to consult or follow expert opinion, officially-sanctioned (or officially ignored) harassment or neglect, personal pique, and the like. Admittedly, this kind of conduct does not predominate in most hous-

ing complexes, but it occurs, to a greater or lesser extent, almost everywhere.\footnote{One article which details the impact of association mismanagement on homeowners is Smith, Condos: Ghettos of the 1990’s? 12 DEN. MAG. 44 (1982), which describes the tribulations of several former clients of this author. These people were the victims of a campaign of harassment, which eventually culminated in the ransacking of their apartment. They were, however, unable to sell their unit due to the decrepit condition of the common areas and the high level of monthly assessments. Attempts to reach a political settlement failed, and legal action was commenced, with inconclusive results. Not many such fact patterns have appeared in the reported cases, although more will as time passes. Perhaps the closest reported analogue is found in Scott v. Williams, 607 S.W.2d 267 (Tex. Civ. App. 1980) (investor-owners who controlled the board engaged in extensive self-dealing).}

The owner of publicly traded stock may respond to corporate mismanagement by selling his shares; however, due to the peculiarities of the real estate market, association mismanagement can make sale of a unit in a poorly run complex next to impossible. Local real estate brokers, aware of the community’s problems and conscious of their own potential liability, may steer prospective purchasers away. Shabby maintenance of the common properties—incurable by the individual seller—may deter purchasers; and the immovability of real property makes nationwide marketing difficult. When the frustrated seller lowers his price, he is likely to be rewarded with a number of offers far lower ("low ball offers"), tendered by profiteers who sense his desperation. Thus, the ultimate sales price may be well below appraised value—if the unit can be sold at all.\footnote{The tribulations of selling condominiums in a slow market—where property almost cannot be given away despite reasonable "appraised values"—are being felt in Denver at the time of this writing. See, e.g., Thorn, Condo Sellers Hear Cry of Albatross, Rocky Mountain News, May 12, 1986, at 38, col. 1. A discussion of the distress sale market appears in Natelson, Mending the Social Compact, 66 OR. L. REV. ____ (1986).}

Added to this is the fact that all personal assets of association members are generally vulnerable to the effects of irresponsible official expenditure. This is clearly so if the association is not incorporated; but even if the association is incorporated, it remains true. Members of a property owners association cannot simply fold their tents and leave their shares behind them; their very tents are immovable. Excessive association spending will have to be paid by association assessments. These are enforceable by liens against the individual units. That much is well known. What is not so well known is that most planned community declarations provide that assessments are also the personal obligations of the unit owners. These obligations are therefore enforceable against other personal
assets, and they survive the sale of the property. In this way also, the damage that can be inflicted by association mismanagement can exceed that inflicted through mismanagement of comparably sized business corporations.

Of course the beleaguered unit owner always has an electoral alternative: He can rally a slate of candidates to exorcise the scoundrels. One problem with this is that the damage might already have been done. Additionally, there are other problems. Voting fraud is not unknown, and a questionable election can be challenged only in court. Moreover, the very mismanagement which initially caused problems may make reform impossible: When owners cannot sell their units but must move from the community, they rent them out. Non-resident owners are notoriously difficult to mobilize for an election or for any other community purpose. This writer has seen successful electoral revolutions in renter-dominated subdivisions, but they are exceedingly rare.

What all of this comes down to is the following: People guilty of association mismanagement usually have a streak of obstinacy which makes redress by any method short of legal action almost impossible. Yet litigation is an expensive proposition for middle- and lower-income home owners, especially when management has access to the association treasury to pay its defense costs. Judicial relaxation of the reasonable care standard would raise those costs further and render it even more difficult for plaintiffs to obtain compensation—even if local derivative action statutes hold out the prospect of ultimate reimbursement.

The foregoing tale of woe may also serve to cast some light (or some gloom) upon the motivations of those who "volunteer" to seek association office. While many candidates (perhaps most) run for office with the best of motives, for many others the reasons are more complex. Combined with the natural instinct to do good, there are the same motivations that cause many people to sit on

59. This is provided in most planned community documentation. See, e.g., 1B P. Rohan, supra note 2, at App. C-2, App. - 163.

60. The writer is familiar with only one which was fully successful. There, a home owner (who was not otherwise employed) in a Denver area condominium complex was able to conduct a campaign to educate absentee owners regarding the state of management at the complex. The educational campaign lasted over two years. In the end she was able to obtain enough absentee ballots to revolutionize the makeup of the board of directors.

61. This is true at least where association members may maintain members' derivative actions. See, e.g., N.Y. Not-For-Profit Corp. Law § 623 (McKinney Supp. 1986).
the boards of profit-making corporations for little or no pay: the
lure of prestige, the need for enhanced professional standing, and
an interest in improving one's business connections. There may
also be uglier impulses—desires leashed in business corporations
by the profit motive, but in property owners associations allowed
to run free: the desire to wield power over one's neighbors, or to
deny it to others, or to take personal revenge for actual or per-
ceived slights.

For those home owner fiduciaries whose motives remain pure,
there are institutional devices available to relieve the harshness of
personal liability. Indemnification provisions are now common and
are generally authorized by non-profit corporation laws. Directors' and officers' insurance, once unavailable for association officials, can now be purchased readily from any of several insurance companies. Hence there remains little, if any, justification for im-
posing standards of care less exacting than those appropriate to
the circumstances—and the circumstances mandate standards at
least as high as those imposed upon part-time business directors.

Of course it may be argued that holding association directors
to a reasonable care standard may discourage some from seeking
office. As a practical matter, however, most courts have been ap-
plying business-type due care standards to association directors
without, apparently, causing a significant shortage in the number
of people willing to serve. The real danger is not that there will
be a shortage of personnel, but that the courts will lower the appli-
cable level of care, and thereby invite additional management abuse.

63. 1 P. ROHAN, supra note 2, § 17A.08, at 17A-15 (1986). A variety of companies write such insurance, and the rates or availability have not, as of this date, been affected by the recent rise in liability rates. Moreover, claims on directors and officers insurance are rare. Telephone interview with Porter Berry, insurance agent at McEldowney, McWilliams, Deardeuff & Journey, Inc., Oklahoma City (June 17, 1986).
64. This objection is invariably raised when there is a suggestion that individual officers and directors may be liable for their acts. See, e.g., N.Y. Times, Oct. 26, 1986, Real Estate Section, at 1, col. 1, responding to the decision in Frances T., ___ Cal. 3d ___, 229 Cal. Rptr. 456, 723 P.2d 573, a case in which official neglect was particularly egregious and the alleged consequences—horrible. (Neglect of outdoor lighting over many months despite repeated notice enabled intruder to rape and rob plaintiff.) However, the authors of the Uniform Condominium Act are of the opinion that the ordinary care rule is adequate to “in-
crease the willingness of unit owners to serve as officers and members of the board.” UNIF. CONDOMINIUM ACT § 3-103, comment 1, 7 U.L.A. 505 (1985).
65. See supra note 47.
III. ASSOCIATION OFFICIALS AND THE BUSINESS JUDGMENT RULE

A. Introduction

The reasonable care standard has been an important benchmark in judicial review of the conduct of business directors. However, within one particular sphere the standards of review are lower. Specifically, the courts have been reluctant to second-guess decisions that are essentially entrepreneurial in nature, both because of the inherent unfairness of judging with the benefit of hindsight, and because individual judges are not necessarily trained or experienced in business matters. This judicial solicitude for business decision-making is called the Business Judgment Rule.

Explicit formulations of the Business Judgment Rule differ, but its practical effect has been to widen the scope of official discretion beyond that which would be permitted under a pure negligence standard, so long as certain conditions precedent are met. As a result, business executives and directors exercising professional discretion usually have been protected from liability unless their conduct falls well below the minimum level of due care—perhaps to the level of gross negligence, recklessness, or bad faith.

Despite the fact that property owners associations are not businesses, a few cases have held that their directors and officers are protected by the Business Judgment Rule. Part III will in-

66. The writer of this article is indebted to Steven A. Fishman, Assistant Professor of Law, Oklahoma City University, for bringing some of the developments discussed in this section to his attention. The opinions expressed herein are attributable to this writer alone, as are all errors in fact and reasoning.


68. A.L.I., supra note 46, at 75; see Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982), cert. denied, 460 U.S. 1051 (1983) and authorities collected therein.

69. This is the standard applied in Delaware. Joy, 692 F.2d at 873.

70. A.L.I., supra note 46, at 68.

71. Id. at 68-69. Just how egregious business conduct must be to fall outside the protection of the Rule is quite uncertain. A discussion appears in Arscht, The Business Judgment Rule Revisited, 8 Hofstra L. Rev. 93, 118-21 (1979). Earlier commentaries are collected there at 120, n.118.

quire into the usefulness, if any, of the Rule in evaluating the conduct of the officials of property owners associations. Focus will be on two aspects of the Rule which have recently received considerable attention because of their inherent interest in today's corporate takeover climate. This writer will discuss them because they help to illustrate how the standard of care applicable to fiduciaries generally should be administered when reviewing the actions of association officials.

B. The Requirement of an Informed Decision

Over the past few years there has been a substantial amount of scholarly discussion about the nature of the protection afforded by the Business Judgment Rule and the conditions precedent which must be satisfied before its protection may be invoked. Over the same period, important judicial decisions have been issued, mostly by the federal courts and the courts of New York and Delaware, which have proved the same questions.

Some writers have envisioned the Business Judgment Rule as a "safe harbor" from the uncertainties of the due care standard. According to this analysis, corporate officials who have successfully navigated around the shoals (i.e., the conditions precedent) blocking the harbor may find their sanctuary within. The conditions precedent are set forth more or less as follows: (1) There must be an actual business decision, not simply an omission due to neglect or inattention (although a well-considered decision not to take action is acceptable, of course); (2) The action must be taken in good faith; (3) The persons making the decision must be disinter-


75. A.L.I., supra note 46 at 60-63; In Re Western World Funding, 52 Bankr. 743 (D. Nev. 1985).

76. A.L.I., supra note 46, at 7; Medford Trust Co., 292 Mass. 1, 197 N.E. 649. See also
ested. Self-dealing is not protected by the Rule, and self-dealers will bear the burden of proving their actions reasonable and fair to the corporation;\(^7\) (4) The decision must be an informed one.

It is upon the last condition, especially, that judicial and scholarly eyes have recently been fixed. To be sure, there has long been authority\(^8\) for the position that a business judgment must be an informed one—that a corporate director or officer should collect data before acting. But the requirement had rarely been invoked as a deciding factor in judicial review—until just a few years ago.

1. Recent Cases

In Auerbach v. Bennett,\(^9\) a 1979 New York case, the court had before it a shareholders' derivative action in which a special litigation committee had voted to order its corporate counsel to move for dismissal of the action. The trial judge granted the motion, but his order was reversed by the appellate division. On appeal, New York's highest court reinstated the trial judge's order of dismissal, basing its holding on the Business Judgment Rule. However, the court's analysis was pregnant with future implications:

We turn then to the action of the special litigation committee itself which comprised two components. First, there was the selection of procedures appropriate to the pursuit of its charge, and second, there was the ultimate substantive decision, predicated on the procedures chosen and the data produced thereby, not to pursue the claims advanced in the shareholders' derivative action.\(^80\)

The court of appeals held that the second component of the committee's decision—the substantive part—fell "squarely within the embrace of the business judgment doctrine" and was therefore "outside the scope of our review," but that:

[a]s to the methodologies and procedures best suited to the

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cases cited supra note 74.
78. E.g., Medford Trust Co., 292 Mass. 1, 197 N.E. 649, 655; Casey v. Woodruff, 49 N.Y.S.2d 625, 643 (Sup. Ct. 1944) (Shientag, J.) (court noted that directors had "studied the problems of" their enterprise before absolving them of liability). Other authorities are collected in A.L.I., supra note 46, at 75.
80. Id. at 634, 393 N.E.2d at 1002, 419 N.Y.S.2d at 928.
conduct of the investigation of facts and the determination of legal liability, the courts are well equipped by long and continuing experience and practice to make determinations. In fact they are better qualified in this regard than are corporate directors in general. Nor do the determinations to be made in the adoption of procedures partake of the nuances or special perceptions or comprehensions of business judgment or corporate activities or interests. The question is solely how appropriately to set about to gather the pertinent data.81

Since the holding in *Auerbach*, the courts have demonstrated an increasing willingness to examine the procedures and investigative techniques employed by corporate officials to amass the data necessary to make informed business decisions. In the most celebrated (or calumniated) of these cases, *Smith v. Van Gorkom*,82 the Delaware Supreme Court held that a board resolution approving a cash-out merger was improper due to the inadequacy of the directors' fact-finding procedures. Specifically, the court criticized the hasty conduct of the meeting at which the merger was approved, the lack of advance notice or written documentation, the failure to consider tax implications or to inquire as to the source of the proposed buy-out figure, and several other factors.83 Protests against the decision have been numerous,84 but since *Van Gorkom* there have been several judicial reaffirmations of the requirement that corporate decision-making be truly "informed."85

2. The A.L.I. Project

Although other commentaries have been cited in support of the new judicial emphasis on the requirement of an "informed decision,"86 incomparably the most influential is likely to be the

81. Id. at 635, 393 N.E.2d at 1002, 419 N.Y.S.2d at 929.
82. 488 A.2d 858 (Del. 1985).
83. Id. at 874-78.
84. See Manning, supra note 73.
85. See, e.g., Fitzpatrick v. Federal Deposit Ins. Corp., 765 F.2d 569 (6th Cir. 1985) (director cannot rely merely on representations of propriety from interested parties, but must conduct independent investigation); *Hanson Trust PLC*, 781 F.2d 264 (inadequate inquiry and failure to read reports); In Re Western World Funding, 52 Bankr. 743 (poor state of corporate records showed that directors could not have been informed); *Unocal Corp.*, 493 A.2d 946 (possibility of director interest in corporate defense against tender offer shifts burden to directors to prove reasonable investigation); *Moran*, 500 A.2d 1346 (investigation held sufficient).
86. See, e.g., *Hanson Trust PLC*, 781 F.2d at 274 (citing Arbaugh, supra note 71, and H. Ballantine, *Law of Corporations* 161 (1946)).
American Law Institute’s project entitled “Principles of Corporate Governance: Analysis and Recommendations,” the fourth tentative draft of which was issued on April 12, 1985. A.L.I.’s analysis has not escaped criticism. It is, nonetheless, the product of an institution and individuals respected enough to make future judicial reliance probable. Indeed, the courts have already begun to cite it.

Section 4.01(a) of the A.L.I. project would impose upon directors and officers a standard of due care: “the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.” Section 4.01(c), an attempted codification of the Business Judgment Rule, loosens

87. A.L.I., supra note 46.
88. See, e.g., Hinsey, supra note 73; Fishman, Recent Developments in Fiduciary Duty of Directors and Officers, published in OKLAHOMA CITY UNIVERSITY CONTINUING LEGAL EDUCATION, DIRECTORS’ AND OFFICERS’ LIABILITY (1986).
89. E.g., Hanson Trust PLC, 781 F.2d 264, 274.
90. The full text of § 4.01 is as follows: Duty of Care of Directors and Officers; the Business Judgment Rule
(a) A director or officer has a duty to his corporation to perform his functions in good faith, in a manner that he reasonably believes to be in the best interest of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.
(1) This duty includes the obligation to make, or cause to be made, such inquiry as the director or officer reasonably believes to be appropriate under the circumstances.
(2) In performing any of his functions (including his oversight functions), a director or officer is entitled to rely on materials and persons in accordance with §§ 4.02-.03.
(b) Except as otherwise provided by statute or by a standard of the corporation [§ 1.27] and subject to the board’s ultimate responsibility for oversight, in performing its functions (including oversight functions), the board may delegate, formally or informally by course of conduct, any function (including the function of identifying matters requiring the attention of the board) to committees of the board or to directors, officers, employees, experts, or other persons; a director may rely on such committees and persons in fulfilling his duty under this Section with respect to any delegated function if his reliance is in accordance with §§ 4.02-.03.
(c) A director or officer who makes a business judgment in good faith fulfills his duty under this Section if:
(1) he is not interested [§ 1.15*] in the subject of his business judgment;
(2) he is informed with respect to the subject of his business judgment to the extent he reasonably believes to be appropriate under the circumstances; and
(3) he rationally believes that his business judgment is in the best interest of the corporation.
(d) A person challenging the conduct of a director or officer under this Section has the burden of proving a breach of duty of care (and the inapplicability of the provisions as to the fulfillment of duty under Subsection (b) or (c), and the burden of proving that the breach was the legal cause of damage suffered by the corporation).
this standard somewhat\(^9\) for a corporate official rendering good faith business judgments in which he is disinterested, if "he is informed with respect to the subject of his business judgment to the extent he reasonably believes to be appropriate under the circumstances. . . ."\(^9\) Thus, an official who wishes to qualify for the relaxed standards governing his judgment must first meet what amounts to a reasonable care level in his data gathering.\(^9\)

The authors of the A.L.I. project place considerable emphasis upon the requirement that business judgments be based on adequate information. In a discussion relatively extended for a rather short publication, they suggest several factors that should be considered in determining whether a director reasonably believed himself to be adequately informed. According to the authors, these factors include:

(i) the importance of the business judgment to be made; (ii) the time available for obtaining information; (iii) the costs related to obtaining information; (iv) the director's confidence in those who explored a matter and those making presentations; and (v) the state of the corporation's business at the time and the nature of competing demands for the board's attention.\(^9\)

The report continues:

The different backgrounds of the individual directors, the distinct role each plays in the corporation, and the general value of maintaining board cohesiveness may all be relevant when determining whether a director acted "reasonably" in believing that the information he had before him was "appropriate under the circumstances."\(^9\)

It is worth repeating that the A.L.I. project utilizes the same standard for measuring the quality of corporate data gathering as for other corporate decisions outside the scope of the Business Judgment Rule: the standard of reasonable care.\(^9\)

91. A.L.I., supra note 46, at 7, 10-11, 12, 67, 69, and 75.
92. Id. at 7.
93. But cf. Delaware law, in which a gross negligence standard is applied to both data-gathering and the judgment itself. Smith v. Van Gorkom, 488 A.2d at 858, 873; cf. RESTATEMENT (SECOND) OF TORTS § 300 (lack of due preparation a form of negligence).
94. A.L.I., supra note 46, at 66.
95. Id.
96. Id. at 64-65.
3. Applicability to Property Owners’ Associations

One who studies the fact patterns of the recent cases dealing with informed decision issues may experience an anticlimatic feeling when shifting his attention to property owners association decision-making. From a real life fantasy land of dashing corporate raiders tendering multi-million dollar offers and of high-powered executives devising defense mechanisms that explode on contact—from that ethereal sphere it seems a dizzying descent to a world of landscape contracting and pet regulation.

Yet the characteristics of property owners associations are such that the duty to investigate should be at least as great as in business enterprises of comparable size; perhaps it should be greater. This does not mean, of course, that associations need employ New York corporate counsel, hire “big eight” accounting firms, or commission massive feasibility studies. (Similarly sized business enterprises are not required to do that either.) It does mean that association boards should be expected to undertake some common-sense information-gathering before making important corporate decisions.

It has already been noted that negligent association management can prove to be more damaging to the average unit owner than negligent corporate management is to the average shareholder. This fact alone suggests the need for reasonably high standards. It has likewise been noted that while mismanagement will reduce the value of all units, including those belonging to association officials, it may also (paradoxically enough) serve to perpetuate them in power. Corporate actions that serve to perpetuate existing management have been held, in business cases, to justify an “enhanced” degree of scrutiny.

Moreover, the considerations listed by A.L.I. for determining whether a decision has an informed basis suggest that association officials should adhere to a fairly high level of investigation. For example, the time available for obtaining information may, in a business context, be limited (thereby reducing the data-gathering

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97. See supra text accompanying notes 56-65.
98. In such situations the Delaware courts have applied an “enhanced” degree of scrutiny: They have compelled management to carry the burden of proving it acted in an informed manner. See Unocal Corp., 493 A.2d at 954; Moran, 500 A.2d at 1356.
99. See supra text accompanying notes 94 and 95.
burden imposed) or plentiful (thereby increasing it).\textsuperscript{100} Important association actions are not usually subject to the split-second timing characteristic of the business world. Except in the most uncommon instance, associations can afford a more leisurely course of investigation.\textsuperscript{101}

Additionally, in an association context, the cost of obtaining necessary information is usually low. If, for instance, the board of directors is deciding which landscaping firm to employ, the only significant investigation cost will be the fee for the lawyer (if any) who evaluates each company's proposed contract and negotiates the final result. Other data-gathering procedures, such as interviewing company representatives and telephoning references, are of negligible cost.

Other A.L.I. factors include the "director's confidence in those who explored a matter and those making presentations" and the "different backgrounds of individual directors." Each of these point to a higher standard of investigation for associations than for most comparably sized businesses. Many, if not most, association directors are only minimally familiar with business transactions, and therefore do not possess the rich store of experiences that justifies the exercise of business intuition. It has generally been acknowledged that inexperienced directors must work harder than experienced ones to meet the law's required level of care.\textsuperscript{102} The development of appropriate investigative procedures can serve to protect both association managers and the homeowners who must live with their decisions.

During this writer's course of practice, he had the opportunity to witness numerous association mistakes resulting from inadequate fact-gathering procedures. Some of these were (a) signing overpriced contracts (due to failure to obtain competitive bids), (b) failing to investigate the background of prospective employees and

\textsuperscript{100} Cf. Van Gorkom, 488 A.2d 858 (director liability imposed in part because it had not been determined that there was a true emergency).

\textsuperscript{101} As noted in Part III(C), infra, the property owners association is by nature a different creature than the business corporation. The association is not an entrepreneurial enterprise; it is a device for property preservation. This helps to explain the greater availability of time.

\textsuperscript{102} Anderson v. Akens, 7 F. Supp. 924 (W.D. Ky. 1934), mod'd sub nom. Atherton v. Anderson, 86 F.2d 518 (6th Cir. 1936), mod'd sub nom. Anderson v. Atherton, 302 U.S. 643, 58 S. Ct. 53, 82 L. Ed. 500 (1937). Of course when association directors do have special skills, the level of care required will be adjusted upward. H. Henn, supra note 3, § 234, at 623.
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contractors, substandard budgeting (due to disregard for past experience and/or neglecting to obtain professional assistance), promulgating of rules after inadequate investigation, incurring association legal liability and/or locking the association into disadvantageous contracts (usually due to failure to consult legal counsel), failing to adequately monitor expenses and assessment delinquencies, and failing to read and understand insurance policies.

Professor Fishman has extracted from the recent informed decision cases certain procedural steps helpful in ensuring that business directors do not incur liability for deficiencies in information-gathering. To the extent relevant to associations, these include the following:

(a) Prior notice of important matters to be voted on by the directors, (b) delivery of written reports to directors, preferably prior to the meeting, (c) making appropriate officers available at the meeting to deliver oral reports and answer directors’ questions, (d) directors’ spending time making their decisions, discussing the issues and asking appropriate questions, (e) directors’ review of appropriate original documents or, at a minimum, having an adequate description of the documents available for the review of directors, (f) receipt of reports from counsel, accountants, and experts, where appropriate, (g) not making a decision in a rushed manner without seeking to determine whether time limits imposed are necessary, (h) not making major decisions at the initial meeting, if time is available . . . (j) keeping records of what steps were taken and the reasons for not taking other steps.

In the context of a business corporation, Professor Fishman notes that "this extensive list of procedural requirements will not be necessary to fulfill a director's obligation in approving transac-


104. In this respect the suggestion of A.L.I., supra note 46, at 60 and 73, that it is within the Business Judgment Rule not to seek expert advice is misleading. There may be instances in which such advice can be safely avoided, as when (a) there is an emergency or (b) there is a danger company trade secrets would be betrayed, but these are, respectively, (a) hardly ever and (b) never applicable to associations. Actually, a failure to obtain adequate expert review was a significant reason for the decision in Van Gorkom, since general counsel had been given no advance notice and no valuation study was made. 488 A.2d at 874-78.

105. Fishman, supra note 88, at 33 (material in brackets added); Manning, supra note 73.
tions less significant than a sale of the entire company." However, for reasons referred to earlier, property owners associations should be required to comply with all or most of these procedural requirements when considering their more important decisions; and, where major contracts are being pondered, it would be well to add competitive bidding to the list.

Some specific examples of association decisions and the relative importance of each might be helpful. Two questions which certainly qualify for a complete investigative procedure are (a) whether to hire a professional management company, and (b) which one to employ. Beyond the obvious importance of this decision, there is the fact that, once entrenched, an unscrupulous company can be extremely difficult to dislodge—especially when director terms of office are staggered or there are a substantial number of absentee owners. Employment of a management firm may be the nearest most associations ever come to a “sale of the entire company.” Other important decisions include (c) establishing broad policies on leasing (i.e., whether it shall be permitted and on what terms) and (d) occupancy restrictions based on such factors as age, commercial activity, number of occupants, pets, and family relationship. (Occupancy rules such as these can affect future property values substantially.) Of lesser, but still considerable, importance, are such matters as (e) setting an annual budget, (f) overall maintenance contracting, (g) assessment delinquency policies, and (h) commencing, waiving, or settling major litigation.

A substantial majority of other decisions will require much

106. Fishman, supra note 88, at 33.
108. Planned community documents often set forth a procedure to be followed if the complex becomes obsolescent, is destroyed, or becomes subject to condemnation proceedings. See, e.g., 1B P. ROHAN, supra note 2, Appendix C-4, at App. -216.39. See also ALI-ABA, CONDOMINIUM, PLANNED UNIT DEVELOPMENT, AND CONVERSION DOCUMENTS 340-41 (1985). There may also be statutory regulation of the subject. See, e.g., UNIF. CONDOMINIUM ACT § 2-118, 7 U.L.A. 483-85 (1985). Of course decisions made at this point are even more akin to “sale of an entire company.”
109. In the event problems with the developer have arisen (involving construction defects or otherwise), early and thorough consideration of a lawsuit is imperative. This is so because of the large size of many such claims, the existence of short statutes of limitations, fading memories, the volatility of developers' financial fortunes, and the possibility that turnover of units will prejudice warranty claims in states imposing privity requirements.
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less investigation. Some, such as the making of emergency repairs and small day-to-day equipment purchases, will require almost none.

C. Should the Standard of Care be Relaxed for Association "Business Judgments"?

Having applied a reasonable care standard to association actions generally, and a similar standard to investigation, we must now consider whether the duty of care should be reduced once the conditions precedent to the Business Judgment Rule have been met. In other words, if an association acts in good faith, after reasonable investigation, and in a disinterested manner, may the decision itself be unreasonable? Put another way: Is the "safe harbor"\textsuperscript{110} applicable to profit-making enterprises relevant to property owners associations?

One reason for the Business Judgment Rule is to prevent a court from substituting its own decision for the judgment of those with the responsibility to make it. But careful application of a reasonable person standard will adequately serve that purpose. Other reasons for the Rule arise from the realities of business enterprise:

[Courts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later, since business imperatives often call for quick decisions, inevitably based on less than perfect information. The entrepreneur's function is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem a wild hunch viewed years later against a background of perfect knowledge.

[Additionally], because potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions. Some opportunities offer great profits at the risk of very substantial losses, while the alternatives offer less risk of loss but also less potential profit. Shareholders can reduce the volatility of risk by diversifying their holdings.\textsuperscript{111}

\textsuperscript{110}. See supra notes 75-77 and accompanying text.
Even a cursory review of the foregoing quotation will reveal that the freewheeling standards of the traditional corporate Business Judgment Rule have very little relevance to property owners associations. Such associations are not in existence to engage in entrepreneurship. Their function is not to take risks in hope of realizing big profits. The association’s function is primarily one of property preservation. The association is expected to protect the residential complex and (usually) it is to endure at least as long as the complex does.\(^\text{112}\) In this respect it is more akin to a private trust than to a business corporation. The trustee’s prudent investor rule is a surer guide for the association official than is the Business Judgment Rule.\(^\text{113}\)

Fortunately, those cases which have purported to apply the Business Judgment Rule to property owners associations have actually imposed a standard of reasonable care. Thus Schwartzmann v. Association of Apartment Owners of Bridgehaven\(^\text{114}\) purported to rely on Professor Fletcher’s truly frightening (frightening, that is, in this context) statement of the Rule, which, if taken literally, would absolve even errors “so gross that they may demonstrate the unfitness of the directors to manage the corporate affairs.”\(^\text{115}\) But in applying the Rule, the court actually imposes an obligation of ordinary care.\(^\text{116}\) Similarly, in Rywalt v. Writer Corp.,\(^\text{117}\) the Rule is first summarized as merely requiring “good faith” and “an honest business judgment;” but that summary is immediately followed by a reference to a requirement that business judgment be “reasonable.”\(^\text{118}\) A comparable process can be discerned in yet another decision, Papalexiou v. Tower West Condominium.\(^\text{119}\) In other cases where courts reviewed association administrative action, the Busi-

\(^{112}\) In some situations longer, as when the complex is destroyed; in other situations it may be terminated after a period of time, usually 20 years. See, e.g., Declaration of Covenants, Conditions, and Restrictions, Yorktown Homes (Filed for record, Book 1917, Page 878, Adams County, Colorado) at 893 (twenty years, with provision for automatic renewals).

\(^{113}\) The “prudent investor rule” is essentially a reasonable care standard, with some emphasis on preservation of principal. G.G. Bogart & G.T. Bogart, supra note 51, at 388-92; see also Restatement, The Law of Trusts §§ 227, 228.

\(^{114}\) 33 Wash. App. 397, 655 P.2d 1177.

\(^{115}\) Id. at ___, 655 P.2d at 1180.

\(^{116}\) Id. at ___, 655 P.2d at 1181. Of course the fact that formulations of the Rule do not always suggest a lower standard of care assisted these courts in reaching the decisions they did. See N. Lattin, supra note 111, § 78, at 273-74; Arscht, supra note 71, at 120-21. But cf. A.L.I., supra note 46, at 75-76.


\(^{118}\) Id. at ___, 526 P.2d at 317.

ness Judgment Rule was referenced explicitly, but the standard applied—ordinary care, the rule of reason—has been the same.\footnote{E.g., Schmeck, 441 So. 2d 1092; Ryan v. Baptiste, 565 S.W.2d 196 (Mo. Ct. App. 1978).}

Thus far, therefore, judicial discussion of the Business Judgment Rule in association cases has entailed a great deal of harmless error. But the harmlessness of the error should not make one sanguine, for loose judicial talk can be dangerous. The Rule was designed to protect the kind of free-wheeling entrepreneurship which can be a real asset in business. But neither entrepreneurship nor the Rule's relaxed standards have any place in the government of a property owners association.\footnote{121. It is also inappropriate for reviewing association rule making, an unfortunate suggestion found in Note, Judicial Review of Condominium Rulemaking, 94 HARV. L. REV. 647, 666 (1981). It is worth noting that removing the Business Judgment Rule from the standard of care applicable to associations would render unnecessary the dual standard adopted by the court in Frances T., ___ Cal. 3d ___, 723 P.2d 573, 229 Cal. Rptr. 456 (1986) (different standards of care owed to association member \textit{qua} member and association member \textit{qua} third party).}

\textit{D. The Standard of Care and the Business Judgment Rule: Conclusion}

The majority of cases and commentators are correct in favoring the application of a standard of reasonable care to the conduct of association officials. However, this standard should be imposed, not quite as it would be in a business enterprise, but with consideration for the fundamental purpose of the property owners association: to preserve and ensure the enjoyment of a designated parcel of real estate. Since an association is not an entrepreneurial enterprise, the Business Judgment Rule, insofar as it serves to reduce the standard of care, cannot be properly applied in reviewing the conduct of association officials. Since those officials are not subject to many of the time constraints common in business, and because their background in such matters is often scanty, they should undertake somewhat more investigation before making decisions than would be required of competent business directors. It is worth noting that there is now a considerable amount of literature available to assist them in their deliberations.\footnote{122. See sources cited supra note 2.}
IV. THE DEVELOPER AS FIDUCIARY

A. The Involuntary Trustee

On the whole, the commentators, and some cases, have emphasized the fiduciary obligations of planned community developers to a greater degree than they have emphasized those of association officials elected by the property owners.123 It is undeniable that developers have some duties which, in a loose sense, can be called "fiduciary." However, as will be seen, those duties are really identical to more general obligations imposed by tort and contract law. Duties arising outside of those general obligations—that is, those which are uniquely fiduciary in nature—do not belong on the developer's list of duties, despite strenuous efforts by some judges and many commentators to place them there.

This Part will examine the theories by which the courts have imposed "fiduciary" liability upon developers. It will also probe the extent to which those theories are appropriate in determining the scope of developer duty, and will reach certain conclusions regarding how developer obligations are (or should be) different from those of other association officials.

123. A good example of this is to be found in the Uniform Condominium Act. The Act provides that "officers and members of the executive board are required to exercise (i) if appointed by the declarant, the care required of fiduciaries of the unit owners and (ii) if elected by the unit owners, ordinary and reasonable care." UNIF. CONDOMINIUM ACT § 3-103(a), 7 U.L.A. 504 (1985). Cf. UNIF. COMMON INTEREST OWNERSHIP ACT § 3-103(a), 7 U.L.A. 328 (1985); UNIF. PLANNED COMMUNITY ACT § 3-103(a), 7B U.L.A. 78 (1985). The practical effects of this distinction are nowhere explained in the comment. The comment does state that a "very high standard of duty" is imposed on developer-nominees because "the board is vested with great power over the property interests of the unit owners, and because there is a great potential for conflicts of interest between the unit owners and the declarant." The comment then adds that the lower standard for directors elected by the unit owners is to "increase the willingness of unit owners to serve." 7 U.L.A. at 505.

Surely the drafters of the Uniform Act could have done better. Are we to conclude that directors elected by the unit owners are not fiduciaries—that they have no obligations of loyalty or good faith? Are we to conclude that the primary loyalty of the developer-nominees is, or should be, to the unit purchasers rather than to their own company? Some of the implications of the second question are discussed later in this Section.

A good example of a judicial attitude mirroring that of the Uniform Act is found, between the lines, in Troy v. Village Green Condominium Project, 149 Cal. App. 3d 135, 196 Cal. Rptr. 680 (1983) aff'd sub nom. Frances T. v. Village Green Owners Ass'n, ___ Cal. 3d ___, 723 P.2d 573, 229 Cal. Rptr. 456 (1986) in which the court refused to follow the clearly applicable precedent of Raven's Cove, 114 Cal. App. 3d 783, 171 Cal. Rptr. 334, which had imposed fiduciary liability for negligence on association directors who were developer-nominees. The only real difference between Raven's Cove and Troy was that in the latter case the directors had been elected by the unit owners.
Three theories have been employed to impose fiduciary obligations upon development companies and their nominees: (1) the developer is a corporate promoter (the association being the "corporation" promoted);\(^{124}\) (2) the developer is a controlling shareholder;\(^{126}\) and (3) the developer's nominees are association directors and officers.\(^{126}\) In commencing an evaluation of these theories it is worthwhile to remember that a real estate developer never incurs fiduciary liability if he confines his activities to building and selling traditional, unrelated single-family homes (although he can incur legal liability on other grounds, of course).\(^{127}\) A few courts have suggested that inequality of bargaining power may require a developer to make full disclosure of certain facts\(^{128}\) and to warrant the quality of his construction,\(^{129}\) but few would claim that such duties are fiduciary in nature. Only builders who undertake to provide their buyers with the advantages of a planned community are subject to the risk of fiduciary liability. Given the widely held belief that planned communities better serve the public than do subdivisions of unrelated homes, this is an ironic result.\(^{130}\)

This result is more an accident of legal process than a matter of conscious policy. Long before the first developer/fiduciary duty case arose, applicable statutes provided that most planned communities, or at least those with more than a certain number of units, 


\(^{127}\) These grounds include breach of express warranty, breach of implied warranty of habitability, negligence, and fraud. There is now extensive literature and voluminous case law on the subject of developer liability. Many of the warranty cases are collected in Richards v. Powercraft Homes, 139 Ariz. 242, 678 P.2d 427 (1984). A recent article discussing the topic's relevance to condominiums is Diamond & Raines, Consumer Warranty Issues in the Sale of Residential Condominiums, 20 REAL PROP., PROB. & TR. J. 933 (1985). For a good discussion of negligence, see Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041 (Colo. 1983).


\(^{130}\) See, e.g., HANDBOOK, supra note 10, at x; THE REPORT OF THE PRESIDENT'S COMMISSION ON HOUSING 81 (1982).
had to be governed by property owners associations. Many also specified, and still do specify, that the association must be established before the first unit sale. An association requires directors and officers, especially (but not exclusively) if the law requires its incorporation. Since incorporation documents usually must include the names of the members of an initial board of directors, the developer has had to staff the board as best he could—generally with his company’s principals, employees, associates, or attorneys. In this writer’s experience, persons selected to serve as nominee-directors have often conceived of their offices as mere paper positions, assumed merely to accommodate an employer, business partner, spouse, or client.

When the developer sold his units, he attached association memberships to them, in compliance with applicable statutes. The builder no doubt thought of himself as selling only real estate, but the presence of the association, dormant though it might have been during the sales campaign, rendered matters quite different in the eyes of most courts. The ordinary housing vendor was now a “corporate promoter.” His firm and its director-nominees had been transformed into “fiduciaries” by virtue of their “controlling shareholder” position in the association. Those employees and spouses who had assumed their directorships to be mere paper positions found themselves vulnerable to a wide range of liabilities. Their duties were said to run, not just to their own company and its shareholders, nor even merely to the association itself, but to purchasers and prospective purchasers as well. Suddenly the developer and his associates were no longer mere business people; they had become virtual trustees.


135. See, e.g., Raven’s Cove, 114 Cal. App. 3d at 800, 171 Cal. Rptr. at 343.
Viewed in the foregoing manner, these results can seem artificial and unfair. But to a certain extent they are both necessary and appropriate. Throughout his sales campaign, a developer collects property assessments and manages the planned community. As the custodian of other people’s property, it is proper to charge him with a number of obligations loosely thought of as “fiduciary”: good faith, due care, legal compliance, and proper record-keeping. Difficulties arose only when courts, state legislatures, and (especially) commentators, started taking the word “fiduciary” too seriously and/or applying it too thoughtlessly. Such errors can be most easily identified amid the fallout from the condominium promoter cases of the 1960’s and 1970’s.

B. The Promoter Cases: Commentator Abuse of Alleged Developer “Abuse”

The two seminal cases on the duties of promoters of business corporations were decided in the early 1900’s. Each arose from the promotion of the same company. In *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, Justice Holmes, writing for the United States Supreme Court, sustained a demurrer by a promoter who had been sued by his corporation. The corporation sought restitution of profits arising from self-dealing between the promoter and the corporation when the latter was still under promoter control. The decision is summarized by Professor Henn:

Here the theory was, as expressed by Holmes, J., that any duty was to the corporation as it then existed and not as it was contemplated. Since there was full disclosure to all persons having a present interest in the corporation, there could be no wrong to the corporation. Even if there had been a technical wrong, it was condoned. If the later shareholders were defrauded, they could sue in their own behalf.  

The second case, *Old Dominion Copper Mining & Smelting Co. v. Bigelow*, decided by the Supreme Judicial Court of Massachusetts, had a different result. There, a similar demurrer was overruled. As summarized by Henn:

The Massachusetts court’s theory was that the promoter’s du-

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ties to the corporation were coextensive with the promotional plan. Disclosure had to be to the corporation not only as it existed but as it was contemplated, and the entity could be looked behind to see if there had been such full disclosure. Disclosure to all of the existing shareholders, when originally-authorized shares were reserved as part of the promotional plan for additional shareholders to whom there was no disclosure, did not constitute full disclosure to the corporation.

* * *

Under either the Bigelow or the Lewisohn rules, where all of the originally intended shareholders have knowledge, the subsequent issue of shares to uninformed outsiders makes no difference. The corporation has no cause of action.

It is commonly said that promoters have fiduciary duties inter se. Since they are in a position comparable to that of co-partners or joint adventures, their responsibilities encompass the same broad scope of duties which partners and joint venturers owe each other. It is also said that promoters have "fiduciary" duties to their corporation and to future shareholders. Yet the Lewisohn and Bigelow cases suggest that any such duties are extremely narrow. Over the years, the rule of Lewisohn has been largely abandoned for the slightly broader rule of Bigelow, but full disclosure to present and prospective shareholders has generally been held sufficient to enable promoters to escape "fiduciary" liability to those shareholders or to the corporation. To be sure, there is a great deal of judicial discussion of other duties, but nearly always the deciding factor has been the adequacy of disclosure. Quite properly, the courts have recognized that a prospective purchaser who has not yet committed himself, but who has been given adequate information, should make his own decisions without judicial supervision.

It is probably misleading to refer to the promoter's duty of

139. H. Henn, supra note 3, § 104, at 241-42.
140. Id. at § 104, at 238-39.
141. Id. at § 104, at 243.
Sometimes promoter "fiduciary duties" are invoked to punish theft. See, e.g., Bovary v. H.M. Bylesby & Co., 27 Del. 381, 38 A.2d 808 (1944); May v. State, 240 Miss. 361, 127 So. 2d 423 (1961).
disclosure as a "fiduciary" obligation at all. The initial characterization of the promoter-corporation relationship as "fiduciary" was apparently a device for holding promoters liable for non-disclosure or concealment (as opposed to affirmative misrepresentation) that was not otherwise actionable at common law.\textsuperscript{143} Since then, however, the law of fraud and misrepresentation has grown so as to encompass nearly all concealment cases and many nondisclosure cases; there is rarely a need to posit a "fiduciary" relationship between the parties.\textsuperscript{144}

Moreover, where the courts have not imposed disclosure duties, such duties have often been mandated by statute. One commentator has wisely suggested that a promoter's obligation of disclosure is more nearly akin to the disclosure requirements of federal securities law than to true fiduciary duty.\textsuperscript{145} The Illinois Appellate Court seems to agree: It has held that comparable disclosure requirements in a Chicago city ordinance were not fiduciary in nature, but had the effect of eliminating any need for fiduciary duties by putting "the developer and prospective purchasers on as nearly an even footing as possible."\textsuperscript{146}

The risk one runs when using the word "fiduciary" to describe the duties owed by promoters to their corporation and to their subscribers, lies in suggesting that there is a relationship quite different from the one which actually exists. There is an implication that the law does, or should, impose responsibilities much broader than those which are, or should be, imposed. Not surprisingly, the initial classification of promoter's duties as "fiduciary" has resulted in confusion in property association law, and, as will be seen, the confusion persists to this day.

After the decisions in \textit{Lewisohn} and \textit{Bigelow}, the next major historical development of interest occurred in the middle and late 1950's. That was a time of extensive litigation between New York cooperative housing associations and the companies which had created them.\textsuperscript{147} In the leading association case of the era, \textit{Northridge}

\textsuperscript{144} Id.; see also \textit{Restatement (Second) of Torts} §§ 550, 551, and illustrative cases cited infra note 194.
\textsuperscript{146} Jones v. Eagle II, 99 Ill. App. 3d 64, 424 N.E.2d 1253, 1260.
the New York Court of Appeals acknowledged a parallel between the promoter/purchaser arrangements in profit corporations and those in housing cooperatives. In *Northridge*, the developer had retained ownership of the land upon which the cooperative was situated, and while in control of the association had caused it to sign a long-term lease with him. The purchasers claimed the rent was excessive, but the court found that they had known of the arrangement before purchase and had signed subscription agreements approving it. The court did make reference to "fiduciary duties" (as most cases of this nature do), but the fact that it made no inquiry into the fairness of the lease indicated that it considered the only real duty to be one of full disclosure.  

The rule applied in *Northridge* was thus the doctrine of *Bigelow*. It did not always work so well for developers. The same year *Northridge* was decided, the New York Supreme Court sustained a complaint brought in similar circumstances by another cooperative association, where the complaint had alleged that "a substantial number of plaintiff's present stockholders had entered into subscription agreements for the purchase of common stock of plaintiff, and had paid for such stock" prior to the complained-of acts. Similar results were reached in other cases. 

The New York cooperative cases were followed by the Florida condominium cases: Four reported decisions date from the late 1960's and early 1970's. In the first of these, *Fountainview Association, Inc. #4 v. Bell*, the district court of appeal considered a long-term recreation-area lease, a property conveyance, and a long-term management contract, each entered into between the association and its developer while the former was still under control of the latter. The association had subsequently passed to home-owner control and was now seeking damages from the developer for what it alleged were "exorbitant" rental and management fees.

The *Fountainview* court affirmed dismissal of the association's claim, reluctantly concluding itself to be bound by *Lake Mabel*
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Dev. Corp. v. Bird, a 1930 Florida Supreme Court decision in the Lewisohn line of authority. Since for Lewisohn purposes, notice to future shareholders was not relevant, the opinion did not discuss whether prospective purchasers had been advised of the relationship of which they were complaining.

On appeal, the Florida Supreme Court affirmed per curiam on the strength of Lake Mabel. Justice Ervin wrote a seething dissent, however, in which he assailed "secret profits," and suggested that the prospective purchasers had not in fact been apprised of the developer's self-dealing. Of course, adoption of the Bigelow, rather than the Lewisohn, rule would have met this objection, but Justice Ervin made it clear that he had broader purposes in mind:

From the allegations of the complaints it appears the Respondent directors and officers [i.e., the developer nominees] at all times occupied a fiduciary or quasi-fiduciary relationship to the condominium nonprofit corporations or associations and their members, and as such they were bound to exercise corporate powers primarily in the interest of the condominium corporations or associations and not for their conflicting personal interests.

* * *

. . . [E]ven if the chancellor had been correct in believing the defendants were the sole members of the corporations at the time of the transactions complained of, the defendants' duty to prospective members of the particular condominium corporations was as great as it would be toward existing members.

In support of the last statement, Justice Ervin cited Bigelow, Northridge, and one of Northridge's progeny, none of which actually stood for anything of the kind.

In 1968 and 1970, the same district court of appeal which had decided Fountainview issued opinions in Wechsler v. Goldman and Riviera Condominium Apartments, Inc. v. Weinberger; and in 1973, the Florida Supreme Court followed with Point East

153. 99 Fla. 253, 126 So. 356 (1930).
154. 214 So. 2d at 610-11 (material in brackets added).
Management Corp. v. Point East One Condominium Corp., Inc.\textsuperscript{158}

In each of these three new cases, similar self-dealing arrangements were upheld. But in each of them the holding stressed the fact that the purchasers had, before sale, agreed to the very arrangements which they later purported to find obnoxious. Thus the Florida courts continued to reach pro-developer results, but had sidled away from the extreme position of Lewisohn and Lake Mabel (no disclosure necessary) to the more reasonable "full disclosure" stance of Bigelow and Northridge. Not too long after, in fact, the Florida Supreme Court used the same rule to award victory to a condominium association.\textsuperscript{159}

But the progress from Lewisohn to Bigelow did not seem to matter to Justice Ervin or to the commentators who lionized him for the stand he had taken. Fountainview, Wechsler, Riviera, and Point East were the targets of a firestorm of protest, and this protest acknowledged no distinctions between them. One writer reached the incredible conclusion that:

\begin{quote}
[i]n most jurisdictions the developer is treated as a fiduciary acting on behalf of unknown persons who will purchase and become members of the association. Under this theory any overreaching could result in voidable sales contracts. However, as illustrated by the Fountainview, Riviera, and Wechsler decisions, the Florida courts reject the majority position. . . . Since the rights of innocent parties did not arise until closing, developers could use legal gymnastics to gain exorbitant profits.\textsuperscript{160}
\end{quote}

The comment was an inaccurate one, for, as we have seen, promoter duties are pretty much limited to full disclosure, and Florida was well within the judicial mainstream in adopting this position. But as misfortune would have it, Justice Ervin quoted this language in his dissent in Point East the following year. This second dissent illustrated even more clearly than the first that Justice Ervin was serving some cause beyond that of full disclosure, for there had been full disclosure in Point East. His target was developer

\textsuperscript{158} 282 So. 2d 628 (Fla. 1973), cert. denied, 415 U.S. 921 (1974).
\textsuperscript{159} 160. Note, Florida Condominiums: Developer Abuses and Securities Law Implications Create a Need for a State Regulatory Agency, 25 U. FLA. L. REV. 350, 355 (1973) [hereinafter Florida Condominiums]. The first two sentences of this quotation were taken almost verbatim from another commentator, writing one year earlier. Note, Real Property-Georgia's Apartment Ownership Act-Its Scope Analyzed in View of Emergency Condominium Litigation in Other Jurisdictions, 23 MERCER L. REV. 405, 411 (1972).
profits, whether or not disclosed: those “excessive overreaching extractions mulched [sic] from the unit owners.”

Point East was decided in 1973. Over the next three years, the progression of law review articles assailing Florida courts continued. Each castigated the holdings in Fountainview, Wechsler, Riviera, and Point East, and each demanded statutory and judicial reform. There was little, if any, acknowledgement that the “self-dealing” in Wechsler, Riviera, and Point East had been accepted by the purchasers, after full disclosure, as part of the bargain; nor was there any investigation of whether the purchase prices would have been higher without such arrangements.

The circumstances of Wechsler provide a good illustration of just how far purchasers in these cases were from being victimized. The self-dealing complained of involved a 99-year recreation lease to which each buyer agreed, in writing, at the time of purchase. Agreement to the lease was not a condition of sale, and one buyer refused to sign it, yet received his unit anyway. Another buyer who objected to the lease was offered an opportunity to rescind his contract and receive a full refund on his deposit. The trial court had found that no buyer was bullied, threatened, or harassed in any way; that all relevant documents had been made available; that all buyers were vigorous, of mature age, and had had experience in business and other worldly affairs; and that many were represented by legal counsel; and that the developer’s form contracts could be, and were, effectively negotiated and altered both before and after signing.

One commentator criticizing Wechsler nevertheless suggested additional disclosure laws, stating that “[e]ven if the prospective purchaser reads the documentation, he frequently lacks the expertise necessary to assess the reasonableness of the reported costs and estimates of future costs, and is often unwilling to pay for expert advice.” Of course, “expert advice” in this context usually means legal counsel. Why the public or developer should bear the cost of some people’s unwillingness to obtain legal counsel is not clear, especially since no condominium documents can be made fully intelligible to the layperson, however many “disclosure no-

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161. 282 So. 2d at 62. “Mulched” probably should be “mulcted.”
162. See, e.g., articles cited infra note 166.
163. Wechsler, 214 So. 2d at 742-43.
164. Note, supra note 145, at 302 (citations omitted) (emphasis added).
tices” there may be. On the contrary, such notices are likely to mislead potential purchasers into believing that they can safely proceed without counsel, even though real estate acquisition without a lawyer’s advice is almost always a dangerous procedure.165

The real subject of the scholarly criticism was the same target Justice Ervin had selected: not secret profits, but profits alone.166 With some exceptions, writers suggested imposing fiduciary duties upon developers to cure the profit “problem,” and they occasionally referenced cases in which this had been done.167 To these writers, in other words, the doctrine of fiduciary duty was a mechanism to serve their personal redistributionist goals.168

165. The author has recorded a few of his experiences with unrepresented buyers in Natelson, Legal Counsel Vital in Real Estate Sale, Denver Post, Dec. 6, 1981, § 6 at 12. Litigation abounds in states such as Colorado, which allow real estate brokers to draft legal documents, and in which the use of attorneys is relatively rare. See, e.g., Lester v. Marshall, 143 Colo. 189, 352 P.2d 786 (1960). Such abuses have led states such as New York to severely limit the legal drafting roles of non-attorneys, resulting in extensive use of attorneys and (in the author’s experience) less post-settlement litigation. See, e.g., Duncan & Hill Realty, Inc. v. Department of State, 62 A.D.2d 690, 405 N.Y.S.2d 339 (1978), appeal denied, 45 N.Y.2d 821, 381 N.E.2d 608, 409 N.Y.S.2d 210 (1978). It is submitted that public policy should be directed toward (1) encouraging consumers to take the steps necessary to protect their own interests, and (2) reducing the possibility of future litigation.


167. E.g., Hyatt & Rhoads, supra note 166, at 973-75; Note, Developer Abuses, supra note 166, at 578 (to his credit, the Memphis writer counsels against the fiduciary duty approach. Id. at 583); Comment, supra note 166, at 983.

168. Other than generalizations about high consumer demand, most of the commentators criticizing the quartet of Florida condominium promotion cases had little to say about specific facts impelling them to conclude that developer profits were excessive. Regarding these (and many other) charges of “exorbitant profits,” several points need to be made.

First, while it is true that at some times and in some places demand for housing is high, at other times and in other places the reverse is true (in the absence, of course, of artificial restrictions on supply due to governmental measures such as rent control). Thus law made based on the assumption of a permanent housing shortage is usually law which is very shortly out-of-date.

Second, purchasers who voluntarily decide to enter an overheated housing market frequently do so as speculators themselves, hoping to “make a killing” (by selling or refinancing) when prices rise even higher. Hence their motives are frequently indistinguishable from those of developers.

Third, even the hottest real estate markets (one might say especially the hottest real estate markets) are characterized by extensive competition among suppliers. Buyers may not be able to haggle down prices in such markets, but their choice of sellers (and therefore
The furor provoked by *Fountainview*, *Wechsler*, *Riviera*, and *Point East* ultimately receded. One reason was that Congress and several of the states passed legislation limiting developer self-dealing, whether or not disclosed and whether or not unconscionable; another was that the *Zeitgeist* of the 1960's and 1970's finally passed away. Since that time, most courts dealing with promotion of planned communities have limited themselves to protecting purchasers from promoter fraud and mismanagement. Still, reported cases remain on the books which describe promoter duties in a manner suggesting that they are broader than they really are. These cases should be utilized with caution; and the articles

their choice of other features) is a wide one. Justice Ervin's suggestion that the agreements in *Point East* were "what amount to adhesion contracts" (282 So. 2d at 632) is, at bottom, untrue, since the large number of sellers enabled any purchaser who did not like these "adhesion contracts" to take his business elsewhere. (Cf. Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69, 94 (1960) (limited number of suppliers all using the same warranty form).

Fourth, the "exorbitant profits" of Florida condominium builders in the late 1960's and 1970's must be considered in light of the fact that they were paying some of the highest construction loan rates in recent history and were also paying high land costs. Additionally, most builders had probably never seen such profits before, and would probably never see them again, and the fluctuating nature of the real estate market generally ensures that "exorbitant profits" in good years will be offset by losses or small profits in lean years.

Fifth, data that seem shocking when considered in isolation are often less so in context. While 1975 B.Y.U. L. Rev. at 297, n.18 quotes the Florida attorney general to the effect that "developers investing as little as $2 million in recreational facilities typically reap unconscionable profits of between $3 million and $6 million annually," Note, *supra* note 145, at 297, n. 18 (emphasis in the original), we are not informed (1) what the value of the land would have been for other uses, (2) the effect (if any) of leases in lowering the sales price of units, (3) the advantages (if any) to the purchasers of, in effect, financing part of their purchase price, (4) the advantages (if any) resulting from the developer bearing some of the potential tort liability arising out of the use of the facilities, and (5) why (assuming proper disclosure) the (generally sophisticated) purchasers of Florida condominiums freely agreed to these kinds of arrangements.


171. *E.g.,* *Raven's Cove*, 141 Cal. App. 3d at 800, 171 Cal. Rptr. at 343 (citing Hyatt & Rhoads, *supra* note 166 and Note, *Florida Condominiums, supra* note 160); *see also* Johnson v. Nationwide Indus., Inc., 450 F. Supp. 948, 954 (N.D. Ill. 1978) (implying that promoter's "fiduciary duty" should be applied to third party to transaction).
and commentaries that spawned them should be retained only as museum pieces, reflective of the times in which they were written.\(^\text{172}\)

C. Fiduciary Duty and the Construction Defects Cases

It has already been noted\(^\text{172}\) that there is no conceptual or practical problem in imposing upon a developer in control of an operating association certain obligations which can be loosely characterized as "fiduciary." Certainly, a person who has purchased a unit in a complex during the period of builder control should be able to expect that the complex will be competently managed, that there will be a due regard for corporate formalities, that income and expenses will be carefully accounted for and properly utilized, and that the owners of all units (including the developer) will comply with the terms of the community's organizational documents and with applicable law. One can avoid the term *fiduciary* when referring to these duties because each can be grounded in the contractual relations of the parties\(^\text{174}\) and in more ordinary obligations of due care.\(^\text{176}\)

The majority of courts imposing "fiduciary" liability on controlling developers have done so in appropriate fact patterns. In most of these cases, the builder has dominated the association for an extended time, but has mismanaged it sorely. It is difficult, for example, to sympathize with a developer who collected assessments for years, yet left the association wholly without reserves for capital replacement;\(^\text{178}\) or whose nominees never attended a board meeting, but gave oral proxies to their resident manager instead.\(^\text{177}\) It is equally difficult to sympathize with a builder who failed to collect assessments from delinquent owners,\(^\text{178}\) or to pay them him-

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\(^{172}\) One might add, with the great Trajan: "Nam et pessimi exempli, nec nostri saeculi est." *Pliny, Epp.*, 10.97.

\(^{173}\) Part IV(A) *supra*, last paragraph in text.


\(^{175}\) *Restatement (Second) of Torts* §§ 298, 299, 300 (1981).

\(^{176}\) See, e.g., *Raven's Cove*, 114 Cal. App. 3d 783, 171 Cal. Rptr. 334.

\(^{177}\) See, e.g., *Hillcrest Condominium Ass'n v. Heftler Construction Co.*, Civil Action No. 79 CV 1601, slip op. (Adams County, Colorado).

\(^{178}\) *Id.*
self;\textsuperscript{179} who did not maintain adequate corporate records;\textsuperscript{180} who plundered the association treasury;\textsuperscript{181} who ignored the rules he himself had issued;\textsuperscript{182} or who caused the association to execute improvident agreements in exchange for secret kickbacks.\textsuperscript{183} In each instance the developer breached some contractual duty, some obligation of good faith or of due care, or some obligation of the general corporate law.

Unfortunately, the imposition of "fiduciary" duties upon developers in such instances has encouraged some writers to go further. Specifically, there has been a tendency to think of the developer's obligations as including the responsibility most distinctively fiduciary in nature: the duty of loyalty. As has already been witnessed, the language in some cases and the positions of some commentators\textsuperscript{184} imply that developers ought to fully disclose their profits, be guided by obligations of trust rather than by considerations of profit in selecting construction methods, avoid "excessive" profit, and wholly refrain from self-dealing.\textsuperscript{185}

The problems inherent in attempting to impose the full range of fiduciary obligations upon developers are exemplified by the construction defects cases. In each of these cases, property owners associations sued developers (or their nominees) on the theory that the defendants had breached their fiduciary duties to the association and/or its members by (a) building units and common properties with construction defects, or (b) failing to repair those defects, or (c) concealing them. Of course, purchasers of residential real estate have other remedies for deficiencies in construction, including remedies for fraud, negligence, and breach of implied and express

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{179} B & J Holding Corp., 353 So. 2d 141.
\item \textsuperscript{180} Fitzgerald v. LaFrenier, 68 S.W.2d 692 (Tex. App. 1983).
\item \textsuperscript{181} Alleged in Hillcrest, Civil Action No. 79 CV 1601, slip op.
\item \textsuperscript{182} St. Francis Courts v. Investors Real Estate, 104 Ill. App. 3d 663, 432 N.E.2d 1274, 1277 (1982).
\item \textsuperscript{183} Note, Developer Abuses, supra note 166, at 573.
\item \textsuperscript{184} See supra Part IV(B).
\item \textsuperscript{185} Presumably, the duty of loyalty would include the usual obligation not to compete with the beneficiaries of the fiduciary obligation or to act for persons whose interests conflict with theirs. See, e.g., \textit{Restatement (Second) of Agency} §§ 393, 394. One can envision an owner suing his developer on the ground that the developer's subsequent activities (building more units in the locality) were inconsistent with these duties since they might diminish the value of the plaintiff's unit by increasing the available supply! Certainly the language employed by the cases and commentators referred to above is broad enough to support a demand that the developer's profits from such a "breach of faith" be disgorged. But cf. \textit{Restatement of Restitution} § 199, comment a (whether a fiduciary is improperly competing with his beneficiary depends on the nature of the fiduciary relation).
\end{enumerate}
\end{footnotesize}
warranties. Yet in the 1970's and early 1980's, claims for breach of fiduciary duty seemed to afford plaintiffs certain advantages over other available theories.\textsuperscript{186} Breach of fiduciary duty may be easier to prove than fraud, for example. Moreover, in jurisdictions limiting warranty claims to purchasers in privity with the developer, fiduciary duty seemed a viable alternative where one or more of the plaintiffs was a remote purchaser. In some states, associations as entities had been denied standing to sue for construction defects if, as is true in condominiums, title to common property was vested in the unit owners rather than in the associations themselves.

The crucial advantage of \textit{breach of fiduciary duty} as a construction defect claim, however, was that it opened up the possibility of recovering any "unjust enrichment" (meaning \textit{increased profit}) that the developer had received as a result of cutting corners on workmanship and materials. It was this factor which made the fiduciary duty theory particularly attractive; for without it, allegations of fiduciary breach were largely redundant of other claims.

The most promising way to obtain restitution of "unjust enrichment," however, was to allege violation of some aspect of the duty of loyalty.\textsuperscript{187} It is here that the conceptual quandary arises, for the conflict between developer and unit purchaser is inherent. If the developer is to honor his obligations of loyalty to his own shareholders, he should spend no more on labor and materials than is required to meet applicable contractual, tort, and warranty standards. On the other hand, a duty of loyalty to prospective purchasers would seem to necessitate adherence to much higher standards of construction quality, irrespective of whether those standards are economically practicable for the builder. Of course, one might contend that it is often more profitable in the long run to utilize top-quality materials and highly skilled craftsmen, but most businessmen know that such is not always true—that some compromises (even some risks) are necessary if housing is to be attractively

\textsuperscript{186} Additional discussion on the scope of theories of developer liability appears in Natelson, supra note 58. See also Diamond & Raines, supra note 127; Hyatt & Rhoads, supra note 166.

\textsuperscript{187} Among the grounds for granting restitution against a fiduciary, breach of the duty of loyalty is probably the most important, at least in this context. \textit{Restatement (Second) of Agency} § 403. Other grounds are set forth in id., § 399, comment on clause (d). These closely parallel violation of the duty of loyalty. Several, such as improper use of a trade secret, are not germane to property owners associations. See also D. Dobbs, supra note 143, § 10.4, at 684-85; see also H. Henn, supra note 3, § 236, at 628-29.
This quandary serves as an excellent example of why fiduciary obligations of loyalty have no place in a relationship which may look fiduciary as a matter of form, but is adverse as a matter of substance.

Similar difficulties arise when the association alleges, not merely the existence of construction defects, but that the developer breached a fiduciary duty by failing to correct them. Naturally, in lawsuits of this kind plaintiffs' counsel are not complaining because the controlling developer failed to spend association funds to effect repairs. They are complaining because the developer failed to spend his funds to make repairs. Yet not all conditions necessitating repair are caused by faulty construction. The question of whether the builder should bear the full cost of correcting a problem can be a close one. If the law is that the developer owes loyalty to two masters, then it unfairly subjects him to risk that he will be liable to either (or both) if he does not guess correctly.

For a time it looked as if the courts would extend developer fiduciary liability to include construction defects. Certainly that would have been consistent with some of the sweeping language of cases and commentaries in the 1970's and early 1980's. For example, in Avila South Condominium Association, Inc. v. Kappa Corp., decided early in 1977, the Florida Supreme Court had laid down the following dictum:

We now reaffirm our decision in News-Journal Corporation v. Gore, . . . and hold that any officer or director of a condominium association who has contracted on behalf of the association with himself, or with another corporation in which he is,
or becomes substantially interested, or with another for his personal benefit may be liable to the association for that amount by which he was unjustly enriched as a result of his contract.\[190\]

Because associations under developer control generally contract (expressly or impliedly) for repair and maintenance work with the developer himself or with related companies, this statement apparently is broad enough to include fiduciary liability for at least some kinds of construction problems.

The next reported case on the subject arose in 1980, when a Connecticut trial judge decided Governors Grove Condominium Association, Inc. v. Hill Development Corp.\[191\] Rather surprisingly, the broad language in Avila was not discussed in the reported decision, nor was Avila even cited as authority. Instead of alleging that the construction deficiencies themselves, or a failure to repair them, constituted a breach of fiduciary duty, plaintiffs' complaint contended that the developer had breached his fiduciary obligations by "concealing roof defects from the association and the unit owners in furtherance of [a] combination and conspiracy. . . . "\[192\]

When the developer moved for dismissal on the basis that the plaintiff had not stated a claim upon which relief could be granted, the court denied its motion. Governors Grove was only a trial court opinion which happened to be reported, but the following year it was cited with approval by a New Jersey court in an opinion subsequently affirmed on appeal.\[193\] Thus a new path to construction liability had been blazed, one which could not go unnoticed by competent plaintiffs' counsel.

Although concealment of known construction defects can be characterized as a breach of fiduciary duty, it can also be characterized as fraud.\[194\] The only advantage to the former theory is the potential for a judgment of restitution if the money the developer saved by its concealment exceeded the damages suffered by the

\[190\] Id. at 607.
\[191\] 36 Conn. Super. 144, 414 A.2d 1177.
\[192\] Id. at --, 414 A.2d at 1183.
plaintiffs. But, again, restitution generally requires a breach of a duty of loyalty, and imposition of a duty of loyalty would unfairly subject the developer to the multiple risks discussed above.\footnote{195}Another disadvantage of imposing fiduciary liability for construction defects is that, for no good reason (and contrary to policy considerations in favor of encouraging planned communities), it establishes two different standards of recovery for purchasers of defective residential property. If a purchaser buys a house in an area not subject to an association and successfully sues for construction defects, his measure of recovery will probably be expectancy damages—more likely than not grounded upon a warranty (i.e., contract) theory.\footnote{196} If the house happens to be part of an association regime, his measure will be expectancy damages or restitution of profits (whichever is greater)—and, since breach of fiduciary duty is a tort theory, perhaps punitive damages as well. The difference in the substance of the transaction (i.e., whether the builder formed a homeowners association) hardly seems a rational basis for such a distinction.

Fortunately, it appears the corner has been turned on this issue. In Olympian West Condominium Association, Inc. v. Kramer,\footnote{197} decided by a Florida appeals court in 1983, the association sued the principals of the corporate developer/builder, who had also served as directors of plaintiff prior to assumption of control by the homeowners. The plaintiff’s theory was that the defendants had breached their fiduciary duty because of construction defects and their failure to correct same.

While the opinion of the court is extremely terse, it appears that the association relied upon Avila, whose wording, as noted above, would appear to be broad enough to sustain their cause. Yet the court upheld the trial judge’s dismissal of the claim, holding that “no cognizable breach of a common law, statutory, or contractual duty is alleged.”\footnote{198} In an opinion just as terse, the same court employed Olympian West to dismiss a similar case the following

\footnote{195. See supra text accompanying note 187.}
\footnote{196. Cost to repair plus consequential losses would appear to be the usual measure of recovery in such cases, although diminution in market value is also used under certain circumstances. See, e.g., Glisan v. Smolenske, 153 Colo. 274, 387 P.2d 260 (1963); D. Dobbs, supra note 143, § 12.21, at 897-907 (1973). For expectancy damages in a common property context, see Natelson, supra, note 58.}
\footnote{197. 427 So. 2d 1039 (Fla. Dist. Ct. App. 1983).}
\footnote{198. Id.}
The Florida tribunal that decided *Olympian West* is perhaps the nation's most experienced appellate court in the realm of association law, so it is improbable that its opinion was short merely because it had nothing to say. The judges no doubt spoke as they did because (1) they now realize the theoretical and practical problems inherent in imposing the duty of loyalty in such circumstances, but (2) they are bound not to attack directly the pronouncements on fiduciary duty made by higher authority, specifically the pronouncements of the Florida Supreme Court in *Avila* and of the Florida Legislature in its statutory imposition of fiduciary duties upon condominium developers.200

**CONCLUSION: DEVELOPER FIDUCIARY DUTY**

There is no conceptual or practical problem in requiring that a developer and his nominees in control of an operating association meet the same standard of care imposed upon officials chosen by owners. Those standards were discussed earlier in this article.201

However, the courts and state legislatures would do well to acknowledge that the developer and his nominees are simply not fiduciaries in the full and traditional sense of the word. For by now it should be clear that it is inappropriate to impose an obligation of loyalty running from the developer to the association or to his purchasers. The developer is not a trustee who has agreed to undertake duties of loyalty toward beneficiaries entrusted to his care. Nor is he the guardian of an incompetent, an attorney acting for a client, or (with respect to his purchasers) even a business executive leading a common enterprise. He is a "fiduciary" only because in a planned community an association happens to be appurtenant to the land. His position is the result of a fluke in the law and of excessive emphasis on form.

The substance of the matter is that developers and purchasers stand in *inherently* adverse positions. The purchaser wants the best deal he can get; the developer is interested in the highest pos-


201. See generally supra Parts II and III.
sible profit. Certainly most purchasers recognize this, even if some courts and commentators do not. In the majority of residential real estate transactions there is enough opportunity for negotiation, and dealings are sufficiently at arms-length, to dispel any inference that the developer is acting as the purchaser’s "trustee."

Other than the planned community developer’s responsibility of managing the association during the sales campaign, most purchasers see no difference between him and any other home vendor; and they are correct, for there is none.

To the extent that a policy of the law is to further the legitimate expectations of the parties, the courts and the legislatures should protect the purchasers’ expectations that the developer will not cheat them, that he will disclose material facts, that he will not violate the duties imposed by ordinary contract and tort law, and that he will comply with corporate formalities in administering the association while it is under his control. But obligations of loyalty do not belong on the list. However tempting the circumstances of an individual case, one should not pretend that they do.

202. This observation was made in a somewhat different form by the court in Jones v. Eagle II, 99 Ill. App. 3d 64, 424 N.E.2d 1253, 1260. It is well borne out by this author’s experience in law practice, much of it acquired in representing parties to residential real estate transactions. (This experience was acquired in widely separated parts of the country.)

Note, however, that this is not to say that developers and purchasers negotiate on equal terms with respect to all aspects of all residential real estate transactions. Although most buyers do not think of builders as their fiduciaries (i.e., have no expectations in that regard), sometimes they do have reasonable expectations which ought not be defeated by undickered terms in fine-print form contracts. For example, the purchaser has a reasonable expectation that his home will be built in a workmanlike manner; that expectation ought not to be defeated by a warranty disclaimer in an inconspicuous part of the builder’s form. Numerous cases have so held, but the reader is cautioned against taking some of the wording of those cases too seriously. All too often that wording is based upon pseudohistory, and/or a lack of understanding of the mechanisms of housing sales. See, e.g., Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314, 326 (1965) ("caveat emptor developed when the buyer and seller were in an equal bargaining position. . . . Buyers of mass-produced homes are not on an equal footing with the builder vendors and are no more able to protect themselves . . . than are automobile purchasers.") Schipper was rightly decided, but the quoted language is largely erroneous as a matter of fact. Yet, like overbroad use of the fiduciary duty doctrine, the notions this language reflects have crept into many other cases. See, e.g., McDonald v. Mianeciki, 79 N.J. 275, 398 A.2d 1283, 1289 (1979); Bethlahmy v. Bechtel, -Idaho at -Idaho at -Idaho at -Idaho at 415 P.2d at 709, Kriegler v. Eichler Homes, Inc., 269 Cal. App. 3d 224, 74 Cal. Rptr. 749, 753 (1969). Surely there is a difference between saying that purchasers cannot protect themselves against certain practices (as a matter of fact, they can), and saying that the law ought not to impose upon them the burden of doing so.