

Shortcuts Can Result in Deep Cuts: Why the Process is Important

By: Kelly G. Richardson

In community association management, corporate formalities so often seem to get in the way of "good old common sense." If someone is doing a good job, and is making good decisions, why allow procedural technicalities to get in the way? Both the cohesive and the chaotic communities all too often dispense with formalities in the name of efficiency.

Let's Not Pretend...

The reality is that boards often hold "working Meetings," against the Open Meeting Act; officers make decisions and sign contracts without board authorization; and boards dispense with formal minutes or records of decisions. The list of other "expedient" shortcuts is endless, and the reader may think of several other major examples.

Why the Process?

In short, the reason to follow proper corporate decision making process is to document that the actions are of the corporation, and not of an individual member of that corporation. California law does not recognize actions as corporate if the law is not followed. The result of a failure to follow proper corporate process is that an obligation thought to be corporate may be imposed upon the individual who failed to obtain proper corporate approval. A manager or director acting without corporate approval may be at risk of having that \$755,000 roofing contract considered as their personal obligation.

Corporate Action vs. Individual Action

A corporation is a legal fiction, recognized by state law as a "person" (Corporations Code §18). It cannot act on its own, since it is a fiction, and must act through authorized agents. A contract, to be considered the corporation's contract, must have been

authorized by the board or have been consummated within the scope of actual or apparent authority conferred by the board. (Corporations Code §208(b)). Actions which are outside the corporate authority are called "Ultra Vires", a Latin term which means "outside the powers". Since the corporation can only act through its agents, the subject of agency is also an extremely important aspect of corporate authority. In small corporations, the officers often act as the primary agents. This is often particularly true of the president or treasurer, but in some associations is another office filled by a very active person. However, officers have only those powers stated in the bylaws, or given to them expressly or by acquiescence of the directors. If the officer acts outside the powers stated in the bylaws, without the express permission or ratification of the board of directors, those actions are not corporate actions.

State law recognizes "apparent" or "ostensible" authority. In this regard, a vendor who contracts with who he/she reasonably believes is authorized by the association may bind the association to the contract, even though the association representative had not been authorized to enter into the agreement. The doctrine of apparent authority does not protect the representative who steps out of authority, but protects the innocent vendor who relied upon that representative. Therefore, it is possible for the corporation to have contract liability imposed upon it against the will of the board. In that instance, the corporation may choose to pursue that representative who caused the liability, and the agent may be personally liable to indemnify the corporation for the act which the board later disavows.

The Importance of Minutes

Perhaps having laid the foregoing foundation, the importance of corporate minutes is now clearer. Minutes document the decisions of the board, and should also document the authorization given by the board to a director, officer, or even the manager to act. The careful manager or officer should insist that its authority to act is always documented in the minutes.

Occasions can arise in which there is no time to convene a board meeting. An urgent situation arises where an officer or manager must make a decision - such as calling an emergency contractor to respond to a flooding situation, for example. In those situations it is imperative to as soon as possible obtain the ratification by the board of the action taken or the contract executed. That ratification, or retroactive approval by the board, then must be documented in minutes.

The Importance of the Open Meeting Act

In the addition of the Open Meeting Act (Civil Code §1363.05) to the Davis-Stirling Act, a new set of corporate procedures were added to all common interest developments in California - whether or not the procedures were reflected in the bylaws. That law contains requirements for advance notice of board meetings, restrictions on the use of executive session, and requires prompt distribution of draft minutes.

Many boards, and unfortunately some managers, allow meetings which circumvent the law. The rationale is almost always that it shortens the board meeting, and makes the discussion more efficient. If an association violates the Open Meeting Act, by not giving proper notice of a meeting, by discussing non-executive session business behind closed doors, or by not distributing timely minutes, are the actions of the Board susceptible to challenge as outside the proper corporate authority? Although the Open Meeting Act does not discuss the consequences of violations, such a result is very possible.

The Dangers of Being the Lone Ranger

Quite often, well-meaning directors or officers step outside of their authority, in

their zeal to "get things done." Most of the time, the remainder of the board tacitly allows the director to make all kinds of commitments on behalf of the association, rarely with documented board authority. While the "Lone Ranger" may be fine most of the time, there are also times when the Lone Ranger is greatly outnumbered. Furthermore, the zealot board member sometimes gets so far out in front of his colleagues that he or she loses sight of consensus, and risks conflict. Worse yet, when the remainder of the board (or a later new board) questions the undocumented actions of this person, he may even be held liable by the very association the person thought he was faithfully serving.

Avoiding Short Cuts, But Not Slow Downs

Proper corporate process is not necessarily slowing down. It is making sure that community is preserved through proper board process, and documenting proper corporate action. Whether a manager or a director/officer, the issue is the same: Don't act until authority is obtained and documented, or obtain that authority as quickly as possible in the event of an emergency situation.

© All Rights Reserved