THE "BUSINESS JUDGMENT RULE" FOR DIRECTORS OF NOT FOR PROFIT CORPORATIONS

By Karen J. Orlin*

In applying versions of the "business judgment rule" to decisions and actions of directors of condominium and homeowners' associations organized under the Florida Not For Profit Corporation Act, Chapter 617, Fla. Stat. (the "FNFPCA") and the Florida Condominium Act, Chapter 718, Fla. Stat. (the "Condominium Act") or the Florida Homeowners' Associations Act, Chapter 720, Fla. Stat. (the "Homeowners' Associations Act"), respectively, courts of, and federal courts in, the State of Florida during 2010 did not rely expressly on statutory provisions for immunity of those directors from personal liability for monetary damages but, rather, on standards of fiduciary duty prescribed by other corporate law statutes and prior judicial articulations of the "business judgment rule."

***Hollywood Towers Condominium Association, Inc. v. Hampton*, 40 So. 3d 784 (Fla. 4th DCA 2010)**

Topics: Authority; Bad Faith; Board of Directors; Business Judgment Rule; Chapter 617; Chapter 718; Condominium Act; Condominium Association; Fiduciary Duty; Good Faith; Injunction; Injunctive Relief; Irreparable Harm; Not For Profit Corporation; Not For Profit Corporation Act; Personal Liability; Reasonable.

Holding: The standard by which a trial court should review the decision of the board of directors of a condominium association organized under the FNFPCA and the Condominium Act to seek injunctive relief against a member/unit owner of that association is an adaptation of the "business judgment rule" under which the court must give deference to that decision if it is within the scope of the association's contractual or statutory authority and is reasonable. For the purpose of this standard, "reasonable" means "not arbitrary, capricious, or in bad faith."

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Practice Tip: The adaptation of the "business judgment rule" articulated by the Fourth District Court of Appeal of Florida as the standard for judicial review of decisions of the board of directors of a Florida condominium association resembles the standard for judicial review of decisions of boards of directors of not for profit corporations previously applied although not articulated by the First, Second and Third Districts Courts of Appeal of Florida (see *Garcia and Garcia v. Crescent Plaza Condominium Association, Inc.*, 813 So. 2d 975 (Fla. 2d DCA 2002); *Cedar Cove Efficiency Condominium Association, Inc. v. Cedar Cove Properties Inc.*, 558 So. 2d 475 (Fla. 1st DCA 1990); *Farrington, et al. v. Casa Solana Condominium Association, Inc.*, 517 So. 2d 70 (Fla. 3d DCA 1987); *Tiffany Plaza Condominium Association, Inc. v. Spencer, Jr., et al.*, 416 So. 2d 823 (Fla. 2d DCA 1982); *Colony Beach and Tennis Club Association, Inc., Colony Beach & Tennis Club, Ltd. v. Colony Beach and Tennis Club Association, Inc.,* 2009 Bankr. LEXIS 4366, 22 Fla. L. Weekly Fed. B 306 *(*U.S. Bankr. M.D. Fla. 2009) (relying upon *Cedar Cove Efficiency Condominium Association, Inc., supra*, as well as *Lake Region Packing Association, Inc., et al. v. Furze*, *et al.,* 327 So. 2d 212 (1976) and *In re: The Bal Harbour Club, Inc.*, 316 F. 3d 1192 (11th Cir. 2003)), but differs from the "business judgment rule" referenced in Section 617.0831, Fla. Stat. and set forth in Sections 607.0831 and 617.0834, Fla. Stat. for determining immunity of directors of a condominium association or other corporation governed by the FNFPCA from personal liability for monetary damages:

The court in *Hollywood Towers Condominium Association, Inc.* articulated the standard for upholding a decision of the board of directors of a Florida condominium association in litigation between that association and one or more of its members/unit owners, other than a derivative action or other proceeding claiming breach by those directors of their fiduciary duties, as *whether that decision is "within the scope of authority" and "reasonable—that is, not arbitrary, capricious, or in bad faith"* (emphasis supplied).

The standard for judicial upholding of a decision of the board of directors of a Florida condominium association applied by the First, Second and Third Districts Courts of Appeal of Florida does not define "reasonable," although the court in *Cedar Cove Efficiency Condominium Association, Inc.* said, "We cannot say . . . that the association . . . acted unreasonably, arbitrarily or capriciously. . . ."

In each case, the burden of proving the elements of the standard is on the defendant condominium association.

In contrast to those standards, the statutory provisions for immunity from personal liability for monetary damages of defendant directors of not for

profit corporations generally in Section 607.0831, Fla. Stat. in the Florida Business Corporation Act, which provisions apply to not for profit corporations under Section 617.0831, Fla. Stat. except as otherwise provided in Section 617.0834, Fla. Stat., *protect those directors,* and similar provisions in Section 617.0834, Fla. Stat. protect officers as well as directors of the kinds of not for profit corporation that are subject to Section 617.0834, Fla. Stat., *in the event of their alleged breach or failure to perform their duties in that capacity* ***unless*** *that breach or failure satisfies one of the exceptions listed in Section 607.0831 or 617.0834, Fla. Stat., respectively,* summarized below, *the burden of proving the applicable exception being on the plaintiff*:

1. A violation of the criminal law, unless the director (or, under Section 617.0834, Fla. Stat., the officer) had reasonable cause to believe the conduct was lawful or had no reasonable cause to believe the conduct was unlawful.

2. A transaction from which the director (or, under Section 617.0834, Fla. Stat., the officer) derived an improper personal benefit, directly or indirectly.

3. Except as stated in clause 4(a) below, recklessness or an act or omission that was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.

4. Otherwise than for the kinds of not for profit corporation that are subject to Section 617.0834, Fla. Stat., (a) in a proceeding by or in the right of a corporation to procure a judgment in its favor or by or in the right of a shareholder, *e.g.*, a derivative action, conscious disregard for the best interest of the corporation, or willful misconduct, or (b) the director's having voted for or assented to a distribution made in violation of the applicable statute, the exception described in this clause (b) being less clear under Section 607.0831, Fla. Stat. as applied under Section 617.0831, Fla. Stat. than it is under Section 607.0831, Fla. Stat. alone, however.

These statutory exceptions from immunity (a) are articulated in *Raphael and Raphael v. Silverman et al.*, 22 So. 3d 837 (Fla. 4th DCA 2009) (summarized in The Florida Bar Business Law Journal Case Law Update 2010, Business Law Section, The Florida Bar ("BLJ 2010") at 59), *Berg v. Wagner et al.*, 935 So. 2d 100 (Fla. 4th DCA 2006), *Accardi v. Hillsboro Shores Improvement Association, Inc., et al.*, 944 So. 2d 1008 (Fla. 4th DCA 2005), *Sonny Boy, L. L. C. v. Bhagwan Asnani, et al.*, 879 So. 2d 25 (Fla. 5th DCA 2004) and *Perlow v. Goldberg and Leb*, 700 So. 2d 148 (Fla. 3d DCA 1997) as *fraud, willful misconduct, self-dealing, betrayal of*

trust, unjust enrichment, criminal activity, bad faith, and malicious purpose, not merely ordinary negligence, and (b) appear to be consistent with long-standing Florida law, not expressly based upon these statutes, to the effect that a court of equity will not review decisions of a corporate board of directors without proof by the plaintiff of absence of authority of that board (*i.e., ultra vires* action) or that board's *abuse of discretion, breach of trust, fraud, illegality, inequity, conspiracy, bad faith, personal benefit or unjust enrichment*. See *Taylor v. Wellington Station Condominium Association, Inc.,* 633 So. 2d 43 (Fla. 5th DCA 1994); *Munder and 444 Inverrary Corp. v. Circle One Condominium Association, Inc.*, 596 So. 2d 144 (Fla. 4th DCA 1992); *B & J Holding Corporation v. Weiss*, *et al.,* 353 So. 2d 141 (Fla. 3rd DCA 1977); *Lake Region Packing Association, Inc., et al., supra*; *Orlando Orange Groves Co., et al. v. Hale et al. and McCutcheon*, 119 Fla. 159, 161 So. 284 (1935).

At least one commentator has suggested that the omission from the list of kinds of Florida not for profit corporation that are subject to Section 617.0834, Fla. Stat. of mutual benefit corporations and other organizations exempt from federal income taxation under Internal Revenue Code ("IRC") Section 501(c)(7) "appears to be an inadvertent oversight" of the Florida Legislature in not amending Section 617.0834, Fla. Stat. when it amended Chapter 617, Fla. Stat. by Laws 2009, c. 2009-205, effective October 1, 2009, to, among other things, add the definition of, and certain provisions expressly relating to, a "mutual benefit corporation." See K. Orlin, "Florida Not For Profit Corporation Act 2009 Amendments," BLJ 2010 at 61, 69, 71-73 and 81.

The term "mutual benefit corporation," as defined in Section 617.01401(13), Fla. Stat., *includes*, among other Florida not for profit corporations:

(a) civic leagues or organizations operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes, that are recognized as exempt under IRC Section 501(c)(4),

(b) labor, agricultural, or horticultural organizations that are recognized as exempt under IRC Section 501(5),

(c) business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues that are recognized as exempt under IRC Section 501(c)(6),

(d) clubs organized for pleasure, recreation, and other nonprofitable purposes that are recognized as exempt under IRC Section 501(c)(7), and

(e) some mobile home associations,

but *excludes only*:

(i) corporations organized primarily or exclusively for religious purposes, recognized as exempt under IRC Section 501(c)(3), or organized for public or charitable purposes and required upon their respective dissolution to distribute their respective assets to the United States, a state, a local subdivision of the United States or a state, or a person that is recognized as exempt under IRC Section 501(c)(3), and

(ii) condominium, cooperative, homeowners' and timeshare/vacation organizations, and corporations in which membership is required pursuant to documents recorded in county property records.

The term "mutual benefit corporation" was deleted from the Model Nonprofit Corporation Act, Third Edition, Committee on Nonprofit Organizations, American Bar Association (© 2009 American Bar Association) ("MNCA"), although the Official Comment to Sections 1.40, 6.11, 6.13, 6.22 and 6.42 of the MNCA suggests that the terms "charitable corporation," defined in Section 1.40(5) of the MNCA as "a domestic nonprofit corporation that is operated primarily or exclusively for one or more charitable purposes," and "membership corporation," defined in Section 1.40(39) of the MNCA as "a nonprofit corporation whose [*sic.*] articles of incorporation or bylaws provide that it shall have members," are used in place of "mutual benefit corporation." Sections 6.11 and 6.13 of the MNCA, regarding transfer of membership, dues, assessments and fees, apply to all membership corporations, and Sections 6.22 and 6.42 of the MNCA, regarding purchase of memberships and capital contributions, apply only to a membership corporation that is not a charitable corporation. The MNCA's counterpart to Section 617.0834, Fla. Stat., Section 8.31(d) of the MNCA, refers simply to a "charitable corporation"; for the purposes of the definition of "charitable corporation," the term "charitable purpose" is defined in Section 1.40(6) of the MNCA as "a purpose that: (i) would make a corporation operated exclusively for that purpose eligible to be exempt from taxation under [IRC] Section 501(c)(3) or (4). . ., or (ii) is considered charitable under law other than [the MNCA] or the [IRC]." Section 8.31(d) of the MNCA, unlike Section 617.0834, Fla. Stat., expressly excepts from the directors' immunity from liability for money damages the directors' voting for or assenting to a distribution in violation of the MNCA under Section 8.33 of the MNCA (contrast paragraph numbered 4 above describing Sections 607.0831 and 617.0834, Fla. Stat.*)*.

Because:

(A) long before enactment of the 2009 amendments to Chapter 617, Fla. Stat., IRC Section 501(c)(7) and other provisions for federal income tax exemption under IRC Section 501(c)(8) *et seq.* (26 U.S.C.A. Section 501(c)(8) *et seq.*) not referenced in Section 617.0834, Fla. Stat. were in effect (see 26 USCS Section 501, United States Code Service (© 2011 Matthew Bender & Company, Inc.)) and Chapter 617, Fla. Stat. applied to, among other not for profit corporations, a not for profit organization now separately defined as a "mutual benefit corporation" (see Section 617.01401(4) and (5), Fla. Stat., substantive amendment of which by Laws 2009, c. 2009-205 related only to distributions),

(B) Section 617.0834, Fla. Stat. was amended in 2009 only in non-substantive, editorial respects,

(C) Section 8.31(d) of the MNCA refers to immunity only for directors of organizations exempt under IRC Section 501(c)(3) and (4), and

(D) Section 8.31(d) of the MNCA, unlike Section 617.0834, Fla. Stat., expressly excepts from that immunity voting for or assenting to unlawful distributions, distributions by some membership corporations other than charitable corporations being permitted by the MNCA just as distributions by some mutual benefit corporations are permitted by Chapter 617, Fla. Stat.,

another reasonable conclusion is that the Florida Legislature intended omission from Section 617.0834, Fla. Stat. of reference to IRC Section 501(c)(7), perhaps so that mutual benefit corporations that are recognized as exempt under IRC Section 501(c)(7) would be governed, instead, by Sections 617.0831 and 607.0831, Fla. Stat.

In the *Conboy* opinion summarized below, concerning a derivative action by members of a not for profit Florida corporation organized as a private equity membership golf and recreational club, the U. S. District Court for the Middle District of Florida applied the "business judgment rule" and the exceptions to it of directors' acting "fraudulently, illegally, oppressively, or in bad faith" in reliance upon Section 617.0830, Fla. Stat. (*i.e.*, neither Section 617.0831 together with Section 607.0831, Fla. Stat., nor Section 617.0834, Fla. Stat.) and upon the opinion in *In re: The Bal Harbour Club, Inc., supra* (which relied not on Florida statutes but, rather, on the earlier decision of that federal appellate court in *Federal Deposit Insurance Corporation v. Stahl, et al.,* 89 F. 3d 1510 (11th Cir. 1996), decided based on pre-1987 Florida corporate law and articulating those exceptions as "abuse of discretion, fraud, bad faith, or illegality").

Similarly, the U. S. Bankruptcy Court for the Southern District of Miami in *Maison Grande Condominium Association, Inc.*, 425 B.R. 684 (Bankr. S. D. Fla. 2010) (summarized in BLJ 2010 at 60), relied on Section 617.0830, Fla. Stat. (*i.e.*, neither Section 617.0831 together with Section 607.0831, Fla. Stat., nor Section 617.0834, Fla. Stat.) and the *Garcia and Garcia, Cedar Cove Efficiency Condominium Association, Inc., Farrington, et al.,* and *Sonny Boy, L.L.C.* opinions, *supra.*

The courts in *Garcia and Garcia, Cedar Cove Efficiency Condominium Association, Inc., Farrington, et al., Tiffany Plaza Condominium Association, Inc.,* and *Colony Beach and Tennis Club Association, Inc., supra,* did not rely expressly on any statutory provision for the "business judgment rule" as applied to the condominium associations or private club that were the subjects of those cases.

And the opinions in *Raphael*, *Berg*, *Accardi*, *Sonny Boy, L. L. C* and *Perlow, supra,* cited as controlling Section 617.0834, Fla. Stat. albeit those cases involved condominium associations and other not for profit corporations that the courts in the respective cases neither acknowledged nor decided were organizations recognized under IRC Section 501(c)(3), (4), (5) or (6) as required for applicability of Section 617.0834, Fla. Stat.

The Florida Legislature may have concluded, therefore, that referencing IRC Section 501(c)(7) in Section 617.0834, Fla. Stat. is unnecessary in order that the "business judgment rule" apply to not for profit corporations recognized under IRC Section 501(c)(7), including "mutual benefit corporations."

The detailed analysis of the history of Laws 2009, c. 2009-205 that is necessary to determine Florida legislative intent and public policy in this regard is beyond the scope of K. Orlin, "Florida Not For Profit Corporation Act 2009 Amendments," *supra*, and this case note.

Conboy v. Black Diamond Properties, Inc., 2010 U. S. Dist. LEXIS 74474 (M. D. Fla. 2010)

Topics: Bad Faith; Board of Directors; Business Judgment Rule; Chapter 617; Conflict of Interest Transaction; Derivative Action; Fiduciary Duty; Golf Club; Good Faith; Interested Director; Membership Club; Not For Profit Corporation; Not For Profit Corporation Act; Ordinarily Prudent Person; Personal Liability; Private Club; Private Equity; Punative Damages; Reasonable; Recreational Facility; Statute of Limitations.

Holding: In a derivative action on behalf of a private equity membership club by its members, plaintiffs failed to establish to the trial court by a preponderance

of the evidence that the directors of the private equity membership club organized under Chapter 617, Fla. Stat. had breached their fiduciary duty to the club and, therefore, defendants' motion to dismiss was granted. Whether the directors breached that duty is determined by applying the standards set forth in Sections 617.0830 and 617.0832, Fla. Stat. and judicial precedent, *i.e*., whether the directors acted in good faith, with the care an ordinarily prudent person in like position would exercise under similar circumstances, in a manner the directors reasonably believe to be in the best interests of the corporation and not fraudulently, illegally, oppressively, or in bad faith, and, if the directors derive a personal benefit from a contract or transaction to which the corporation is or is to be a party, whether the contract or transaction and the directors' relationship or interest are disclosed or known to the board of directors or committee which authorizes it without counting the votes or consents of "interested" directors and the contract or transaction is fair and reasonable as to the corporation at the time it is authorized by the board, committee or members of the corporation.

Chapter 617, Fla. Stat. does not provide for punitive damages for violation of that statute.

The statute of limitations for claims of breach of fiduciary duty is four years under Section 95.11(3) , Fla. Stat.

Practice Tip: Determinations by the trial courts of breaches of fiduciary duty by directors are based upon detailed analyses of all of the facts and circumstances and documentation of deliberations of the board of directors and the agreements and other documents, financial statements and information upon which those deliberations are based. Dismissal of complaint or summary judgment in fiduciary duty disputes, therefore, is rarely upheld on appeal in the absence of that detailed analysis by the trial court. See *Sarasota Tile & Terrazzo Corporation v. DeSoto Terrazo Corporation*, 105 So. 2nd 811 (Fla. 2d DCA 1958) (relied upon by the U.S. Bankruptcy Court for the Southern District of Miami in *Maison Grande Condominium Association, Inc., supra*), *Hollywood Towers Condominium Association, Inc*., *Garcia and Garcia, Cedar Cove Efficiency Condominium Association, Inc., Tiffany Plaza Condominium Association, Inc.* and *Taylor, supra.* But see *Farrington, et al., Raphael and Raphael* and *Accardi, supra.*

Guidance for effective and responsible action by not for profit boards of directors derives from precedents regarding fiduciary duty of boards of directors of for profit entities, such as the opinion of the Delaware Supreme Court in *Smith v. Van Gorkam, 488 A. 2d 858 (1985).*