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BUSINESS JUDGMENT RULE: an outstanding con job!

In short, the business judgment rule (BJR) is an unconstitutional delegation of legislative powers to a private entity. The rule essentially allows the judge to defer to the HOA board as best to decide the matter, denying the *due process of law* for citizens to be heard in court. It is *an unequal protection of the laws*! However, the lawsuit before the court was brought to obtain an independent and supposedly unbiased application of the law. Think about it! The court is rubberstamping the BOD's decision. Say what!

It's nothing more than an understandingly successful con job fostered upon HOA members. The BJR is a poster child for the need for advocates to be fully educated about the laws, government, and the courts. STOP THE CON!

Let me explain as best as I could and keep this complex issue as simple as possible. The courts' adoption and continuing support for the BJR avoids and ignores several constitutional issues at play: 1) delegation of legislative powers, 2) the HOA as a state actor, functioning in the place of municipal government, and 3) the judicial scrutiny doctrine testing the constitutionality of a laws. (WHEW!)

A. BJR statute?

First, be aware that you will not find "business judgment rule" anywhere in state statutes and codes, that's why it's referred to as a "rule." What the reader will find are references to the duties and obligations of directors and officers to be fair, without conflicts, and acting in the best interest of the HOA. This is the basis for the misguided presumption.

> "The business judgment rule is a case-law-derived [made by the courts not legislatures] doctrine in corporations law that courts defer to the business judgment of corporate executives. It is rooted in the principle that the directors of a corporation... are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge.'"
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> "In effect, the business judgment rule creates **a strong presumption** in favor of the board of directors of a corporation . . . . The presumption is that 'in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest.'"

(The Business Judgment Rule).

> "In suits alleging a corporation's director violated their duty of care to the company, courts will evaluate the case based on the business judgment rule. Under this standard, a court will uphold the decisions of a director as long as they are made (1) in good faith, (2) with the care that a reasonably prudent person would use, and (3) with the reasonable belief that the director is acting in the best interests of the corporation. Practically, the business judgment rule is a presumption in favor of the board. As such, it is sometimes referred to as the 'business judgment presumption.'" (Business Judgment Rule, Cornell Law).

This Rule was based on a Delaware court holding as applied to business corporations and has been co-opted and applied to private government HOAs. In HOA-Land we know this is a gross mis-presumption! The HOA and its attorneys are adversaries plain and simple.

Now, in part 2 let's examine what difficult issues have been cleverly bypassed by this court made new law.

B. Delegation of powers – state actors.

Strictly speaking there is no formal, explicit delegation of powers to the HOAs as required by law when the legislature creates a state agency, like real estate, contractors, etc. To make such a law would create the HOA as a state agency or a state actor, and so the attorney "law writers" avoided any such statement,

arguing that it's the private Declaration contract that establishes the HOA.

Under the law of the land the HOA is not de jure -- by law – a local municipal government. Here we see more "word games" — parsing sentences and redefining meanings of words to fit a special agenda. Assessments are not taxes, penalties are not fines, and redefinitions of due process, fair elections procedures, etc. But you can't fool everybody! "*If it walks like a duck, talks like a duck, and looks like a duck, it's a duck*!"

A slick sidestep took place when the US Supreme Court criteria for a state actor/actions were ignored by our learned justices. The criteria cannot be denied by the prevalent events, actions, and facts over some 40 years. The criteria -- gathered from several SCOTUS opinions — are summarized in *Brentwood v. Tennessee School,* 531 U.S. 288 (2001):

1. *From the State's exercise of "coercive power,"*
2. *when the State provides "significant encouragement, either overt or covert,"*

3. *when a private actor operates as a "willful participant in joint activity with the State or its agents*
4. *when it is controlled by an "agency of the State,"*
5. *when it has been delegated a public function by the State*
6. *when it is "entwined with governmental policies," or*
7. *when government is "entwined in [its] management or control."*

You be the judge, excluding items (4) and (5) above. What say you???

Accepting the prevailing opinion that HOAs are not state actors, the validity of the BJR rests on the **implied** delegation of legislative authority by state legislators as evidenced from their conduct consistent with the SCOTUS criteria above. (The courts have used **implied waiver** of fundamental rights by HOA owners as being valid in spite of the doctrine that such waivers and surrenders must be explicit in writing.) The answer is obvious. I strongly believe that there is a valid implied delegation of legislative powers to HOAs that would hold the application of BJR as unconstitutional.

Article I. Section 1, of the US Constitution states that "*All legislative powers herein granted shall be vested in a Congress of the United States*" and state constitutions have similar wordings like that of Arizona, "*The legislative authority of the state shall be vested in the legislature, consisting of a . . . .*" An exception to this delegation was stated by the US Solicitor General who argued, *"that there is no unconstitutional delegation to a private entity because government officials retained control." (*DOT v. Association of American Railroads, 575 U.S. 43 (2015)).

With respect to HOAs, state governments have walked away from any oversight control as exemplified by the application of BJR.

C. <u>Judicial scrutiny – constitutional restraints on laws</u>

Please understand that there is a myth fostered upon the unsuspecting public that the legislative Rules Committees validate, as part of their duties and obligations, the constitutionality of bills before a final vote of approval. **Not so!** Current legal doctrine is that all bills passed by legislatures are presumed constitutional and that any opposition must ardently prove otherwise. Let's remember that the BJR is not a law or a statute but a rule to follow created by a court. It raises the question as to whether or not judicial review applies to rules.

Judicial review / scrutiny is a check on the age-old absolute power that the King/Emperor – the sovereign — could do no wrong, carried over to the sovereign of our republic, the Congress and state legislatures. The first restraint on absolute power came with the English Magna Carta of 1215 (known then as "The Articles of the Barons," signed by none other than Prince John of Robin Hood infamy).

The US version of restraint on the sovereign came with the Constitutions, Federal and state. Enforcement fell to SCOTUS who had to set up rules to guide everyone as to what was a legitimate government right or an unconstitutional violation of the restraint agreement. And so there exists 3 levels of judicial scrutiny to test the validity of government actions: rational basis, intermediate, and strict scrutiny. But first, the decision by a court to support a government act or law had to be filed and then challenged.

> The court will decide, subject to debate, which level applies to a particular challenge.
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> "Strict scrutiny is a form of judicial review that courts use to determine the constitutionality of certain laws. To pass strict scrutiny, the legislature must have passed the law to further a "compelling governmental interest," and must have narrowly tailored the law to achieve that interest.
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> "Intermediate scrutiny is a test courts often use in the field of Constitutional Law to determine a statute's constitutionality. To pass intermediate scrutiny, the challenged law must:
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> 1. further an important government interest (lower burden than compelling state interest required by strict scrutiny test)
> 2. and must do so by means that are substantially related to that interest.
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> "To pass the rational basis test, the statute or ordinance must have a legitimate state interest, and there must be a rational connection between the statute's/ordinance's means and goals."
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> (Legal Information Institute, LII, Cornell Law School).

Which one of these tests will validate the Business Judgment Rule as applied to HOAs? The basis for the court support of this rule was given by the Delaware corporate law, Del. Code Ann. tit. 8, § 141(a),

> "The rationale for the rule is the recognition by courts that, in the inherently risky environment of business, Boards of Directors need to be free to take risks without a constant fear of lawsuits affecting their judgment."

1. Not wishing to pursue the details that the above would qualify for a legitimate government interest under the rationale test: it's acceptable that successful

businesses bring more employment and taxes, and good directors are needed to be protected from the risks of entrepreneurship. So, the **unsubstantiated BJR presumption** that they can do no wrong, or much wrong, was included to justify the BJR protection.

There is an abundance of evidence to solidly refute this presumption with respect to HOA board of directors, and for the courts to reject the application of BJR!

2. Now, it's a little more difficult to justify BJR under the Intermediate Test under requirement (2) above that the government's *means to the end* must be substantially related. Legally "substantial" equates to "important or significant, not illusionary." In street terms, "gotta find a justification for the act."

   I cannot see that director freedom from lawsuits as being significant to the success of a business unless there are crimes or highly questionable legal acts running amuck. Unfortunately, the plaintiff – the homeowner -- would have to solidly prove such rogue actions were prevalent for the court to reject the presumption of innocence. And we know how difficult that can be in HOA-Land.

3. Finally, the acid test for violations of constitutional and fundamental rights and freedoms: the strict scrutiny test.

   > "To survive a challenge that the policy violates constitutional equal protection . . . or a 'fundamental right' is being threatened by a law," the policy must pass strict judicial review.

   To pass a government policy under strict scrutiny the legislature has to pass a "*narrowly tailored*" [there must not be a less restrictive way] and "*compelling governmental interest*" [something necessary or crucial] inquiry.

   I believe that the validity of state HOA Acts, laws, or the governing documents will not pass a strict scrutiny test. For example, a particularly important miscarriage of justice are state laws allowing HOAs to foreclose for nonpayment of assessments because the HOA would fail. There are other less restrictive recourses to collecting nonpayments that are available, such as garnishment, seizure of assets, etc., and used by other organizations including the IRS.

D. **For further study**, see my Commentaries on the failure to not only educate judges but all those graduating law students sallying forth with a half-assed view of the HOA legal scheme. ASU Law ignores content-neutral free speech for HOAs (2020); HOA lawyers take heed! Federal judge chastises lawyers

> *"The [reform] movement will focus on building a large body of scholarship to counteract the new orthodoxy of anti-constitutional and anti-democratic law being churned out by the fever swamps. The Constitution cannot defend itself; lawyers and legal scholars must."*