
USING GOOD JUDICIAL JUDGMENT: DISPENSING WITH THE BUSINESS JUDGMENT RULE IN MIXED-USE COMMUNITY ASSOCIATION DISPUTES

I. INTRODUCTION

Community associations in America are becoming increasingly popular.¹ In addition to their widespread growth throughout the country, community associations are fundamentally changing. Whereas the traditional community association consisted of purely residential members, projects are now becoming more and more mixed use.² Mixed-use projects feature a combination of retail and other commercial operations in addition to the traditional residential development.³ Since they hit the scene in the 1970s, residential community associations have presented courts with numerous disputes with which judges have wrestled to develop a wide body of case law.⁴ While jurisdictions took different approaches to residential community association disputes, reasonably predictable and coherent law emerged from jurisdiction to jurisdiction. Perhaps fatigued, courts in many jurisdictions are applying the same body of case law and corresponding standards of review to mixed-use association disputes, rather than looking critically at the fundamentally different beast that is now stalking the land.⁵

In Vail, Colorado, a group of retail unit owners known as the Lodge Retailers Association (“LRA”) brought an action against their mixed-use condominium association, the Lodge Apartment Condominium Association (“LACA”) for assessing maintenance fees for elements the LRA claimed were uncommon.⁶ The mixed-use condominium consisted of seventy-four units; fifty-nine were for residential purposes, and fifteen were for retail purposes.⁷ In addition to the retail and residential presence in the building, a luxury hotel

1. Janet M. Bollinger, Comment, *Homeowners’ Associations and the Use of Property Planning Tools: When Does the Right to Exclude Go Too Far?*, 81 TEMP. L. REV. 269, 275 (2008).

2. Roger D. Winston, *Achieving Vertical and Horizontal Integration—Challenges of Mixed-Use Development*, PROB. & PROP., Mar./Apr. 2007, at 38, 38, available at http://www.ballardspahr.com/files/tbl_s29GeneralContent/PDFfile2223/66/Attachment7.pdf.

3. *Id.*

4. See *infra* Part II.B for a discussion of residential community association law.

5. See *infra* Part III.A.2 for an argument that courts do not distinguish between mixed-use and residential community associations.

6. Opening-Answer Brief of Plaintiff-Appellee/Cross-Appellant Lodge Retailers Ass’n at 5–8, *Lodge Retailers Ass’n v. Lodge Apt. Condo. Ass’n, Inc.*, No. 05 CA 1864 (Colo. Ct. App. Jan. 8, 2006). The Author assisted the Lodge Retailers Association in this litigation in his capacity as a paralegal for LRA’s counsel. Some of the statements in notes 6–13 and accompanying text are derived from this firsthand experience.

7. *Id.* at 5.

known as the Lodge at Vail (“Hotel”) was interconnected to the condominium, sharing a lobby, walls, and a pool and spa facility.⁸ The LACA board hired the Hotel as the association’s managing agent.⁹ In its capacity as managing agent, the Hotel, with the approval of the LACA board, rolled several hotel-related expenses into the association’s common elements, such as the pool and front desk, and expenses in connection with a vacation rental program.¹⁰ The LRA claimed that they received no benefit from the assessment scheme.¹¹ The obligation to pay for the hotel-related expenses resulted in considerable diminution in the value of their retail units.¹² The LRA thus sought, *inter alia*, declaratory judgment and restitution for overpayment of past expenses.¹³

The LRA, a minority class subject to the will of the residential majority, faced a daunting litigation because of Colorado’s decision—or lack thereof¹⁴—to apply the business judgment rule (“BJR”) in the context of mixed-use community association disputes.¹⁵ The LRA convinced a jury that the assessment scheme was exploitative of minority commercial interests, but ultimately the board and association prevailed because of the BJR defense.¹⁶ The trial court afforded BJR protection to the board’s decision to enter the management agreement with the Hotel, which was a complete defense to LRA’s claims.¹⁷

Colorado and a minority of other states, who use the BJR in the context of mixed-use community association disputes, leave minority membership classes little recourse through the courts to ensure their reliance interests in their

8. *Id.* at 6–7.

9. *Id.* at 5.

10. *Id.* at 5–8.

11. Response to Motion for Judgment Notwithstanding the Verdict at 5, *Lodge Retailers Ass’n v. Lodge Apt. Condo. Ass’n, Inc.*, No. 03 CV 264 (Colo. Dist. Ct. Eagle County July 21, 2005).

12. Plaintiff Lodge Retailers Ass’n’s Initial C.R.C.P. 26(a)(2) Disclosures and Reservation of Rights at Exhibit B, *Lodge Retailers Ass’n v. Lodge Apt. Condo. Ass’n, Inc.*, No. 03 CV 264 (Colo. Dist. Ct. Eagle County Apr. 13, 2004) [hereinafter Plaintiff’s Initial Disclosures].

13. Opening-Answer Brief of Plaintiff-Appellee/Cross-Appellant Lodge Retailers Ass’n, *supra* note 6, at 2.

14. See *infra* Part III.A for a discussion of how courts fail to distinguish between residential and mixed-use community associations for purposes of BJR application.

15. *Rywalt v. Writer Corp.*, 526 P.2d 316, 317 (Colo. Ct. App. 1974) (recognizing business judgment rule in Colorado).

16. Opening-Answer Brief of Plaintiff-Appellee/Cross-Appellant Lodge Retailers Ass’n, *supra* note 6, at 10; see also Edward Stoner, *Lodge at Vail Stores in Court over Fees*, VAIL DAILY, Apr. 16, 2006, available at <http://www.vaildaily.com/article/20060416/NEWS/104160045> (reporting on trial court judgment).

17. Opening-Answer Brief of Plaintiff-Appellee/Cross-Appellant Lodge Retailers Ass’n, *supra* note 6, at 10. Whether the BJR specifically protects a community association board’s decision to enter into a management agreement was recently before the Colorado Supreme Court on a petition for writ of certiorari. Reply in Support of Petition for Writ of Certiorari at 1, *Lodge Apt. Condo. Ass’n, Inc. v. Lodge Retailers Ass’n*, No. 07SC1092 (Colo. Jan. 22, 2008). The Colorado Supreme Court, however, declined to address the issue and denied the petition. *Lodge Apt. Condo. Ass’n, Inc. v. Lodge Retailers Ass’n*, No. 07SC1092, 2008 WL 2486399, at *1 (Colo. June 23, 2008).

properties.¹⁸ This Comment critiques courts in BJR jurisdictions for failing to distinguish between purely residential communities and mixed-use projects in fashioning a standard of review.¹⁹ It further argues that boards of mixed-use projects deserve less judicial deference than the BJR generally requires courts to give.²⁰ Instead of the BJR in the mixed-use context, courts should implement a reasonableness standard that allows them to properly balance the competing interests at stake.²¹

To fully appreciate the problem with applying the BJR to mixed-use community association disputes, it is necessary to understand the evolution of the BJR doctrine beginning in the corporate context and then its adoption in the community association setting. Accordingly, Part II of this Comment reviews the beginnings of the BJR in the for-profit corporate setting and then explores the BJR in residential community associations. That discussion details various rationales offered to support the BJR in the residential community association context. This Comment then looks at the leading alternative to the BJR, known as the reasonableness standard, which is the standard a majority of jurisdictions use in the community association context. Part II concludes with a discussion of the mixed-use community association and analyzes various disputes that arise. It also juxtaposes the BJR with the reasonableness standard as a means of resolving community association disputes in the mixed-use project.

Part III of this Comment highlights the problems with applying the BJR to the mixed-use community association and further argues that each rationale concerning the BJR's deferential approach is inapplicable to the mixed-use project. This Part argues that the reasonableness standard is preferable to the BJR in the mixed-use context because it allows minority owners, legitimately harmed, adequate recourse through the courts. To illustrate the BJR's ineffectiveness in the mixed-use setting, Part III concludes by applying the BJR to the facts of a real-life dispute taken from a case in Maryland, a jurisdiction that uses the reasonableness standard.

II. WALL STREET TO MAIN STREET: THE BUSINESS JUDGMENT RULE COMING SOON TO A COMMUNITY NEAR YOU

To understand the role of the BJR in mixed-use disputes—and to understand why it is inappropriate—it is helpful to consider the evolution of the doctrine, starting first with its birth in the for-profit corporate setting. As residential community associations first became popular and disputes arose, courts struggled to find and adopt a framework of adjudication that adequately

18. See *infra* Part III.B for an illustration of how the BJR fails to protect minority reliance interests.

19. See *infra* Part III.A for a critique of courts' failure to distinguish between residential and mixed-use community associations.

20. See *infra* Part III.A for arguments that courts should be less deferential to decisions of mixed-use associations' boards.

21. See *infra* Part III.B for an illustration of the reasonableness standard's superiority over the BJR in the mixed-use context.

balanced the interests involved.²² The corporate BJR standard and the less deferential reasonableness standard emerged as the two main judicial approaches.²³ Accordingly, Parts II.B and II.C provide a discussion of these standards of review in the residential context. Mixed-use community associations are the latest advancement in community projects and Part II.D explores the trends courts are taking when dealing with mixed-use disputes.

A. *The Business Judgment Rule's Birth in the Corporate Setting*

1. What Is the Business Judgment Rule?

“The business judgment rule is one of the most fundamental doctrines in corporate law.”²⁴ Underlying corporate law in America is the notion that directors, rather than shareholders or judges, manage the business affairs of the corporation.²⁵ In fact, this elemental understanding of corporate management is codified in several jurisdictions, including Delaware.²⁶

The BJR functions primarily as a judicial presumption that directors make business decisions “on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”²⁷ Under the BJR, directors are generally free of liability due to “imprudence or honest errors of judgment.”²⁸ Traditionally, to overcome the presumption, a plaintiff had to present sufficient evidence that a director, or the board as a whole, breached “any one of the triads of their fiduciary duty—good faith, loyalty or due care.”²⁹ Because a director cannot act in bad faith and at the same time fulfill her duty of loyalty, the Delaware Supreme Court dispensed with the triad approach and now treats good faith as a subset of the duty of loyalty.³⁰

22. See Armand Arabian, *Condos, Cats, and CC&Rs: Invasion of the Castle Common*, 23 PEPP. L. REV. 1, 11–18 (1995) (discussing varying judicial approaches to fashioning standards of review in community association context).

23. *Id.*

24. Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1439 (1985).

25. See *Aronson v. Lewis*, 473 A.2d 805, 811–13 (Del. 1984) (providing formulation of BJR in Delaware), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

26. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2001) (“The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . .”).

27. *Aronson*, 473 A.2d at 812.

28. JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS § 10.01, at 184 (2d ed. 2003) (citing *In re Reading Co.*, 711 F.2d 509, 517–18 (3d Cir. 1983)); see also *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979) (noting that BJR “bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes”).

29. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (emphasis omitted) (citing *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989); *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985); *Aronson*, 473 A.2d at 812)).

30. Claire A. Hill & Brett H. McDonnell, *Stone v. Ritter and the Expanding Duty of Loyalty*, 76 FORDHAM L. REV. 1769, 1777–79 (2007) (citing *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006); *In re*

The BJR commonly applies to derivative actions brought by minority shareholders against the directors of the corporation to challenge a particular decision.³¹ Rather than a review of the merits of claims or the reasonableness of a particular board decision, the BJR requires only a process-based analysis.³² In *Brehm v. Eisner*³³ the Delaware Supreme Court acknowledged this process-based approach:

Courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context. Due care in the decisionmaking context is *process* due care only. Irrationality is the outer limit of the business judgment rule. Irrationality . . . may tend to show that the decision is not made in *good faith*, which is a key ingredient of the business judgment rule.³⁴

The BJR is thus a highly deferential standard of judicial review, not a proclamation of a standard of care for directors.³⁵

Although the BJR has unique application in certain derivative situations, its governing principles concerning scope are universal.³⁶ First, the protections of the BJR are only available to disinterested directors.³⁷ In this regard, "directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing."³⁸ Second, the BJR does not protect directors who breach their duty of care, which typically concerns whether the board "inform[ed] themselves . . . of all material information reasonably available to them."³⁹ According to the *Aronson* court, directors' liability with respect to their failure to consider adequate information is predicated on the concept of gross negligence.⁴⁰ In some jurisdictions, action beyond gross negligence approaching criminal is required before the imposition of liability.⁴¹ Finally, the BJR operates only in the context of director action; it has no operation where a *conscious choice* was not made.⁴²

Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967-68, 970 (Del. Ch. 1996)) (discussing evolution of duty of good faith into duty of loyalty in Delaware corporate law).

31. See *Auerbach*, 393 N.E.2d at 1002 (noting that decisions "weighing and balancing . . . legal, ethical, commercial, promotional, public relations, and fiscal" factors fall within BJR).

32. *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000); COX & HAZEN, *supra* note 28, § 10.01, at 184.

33. 746 A.2d 244 (Del. 2000).

34. *Brehm*, 746 A.2d at 264 (second emphasis added) (footnotes omitted).

35. COX & HAZEN, *supra* note 28, § 10.01, at 184 (noting that liability of director whose conduct falls short of industry norm depends on BJR assessment).

36. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

37. *Id.*; see also *Gries Sports Enters., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 964 (Ohio 1986) (discussing scope of BJR under Delaware law).

38. *Aronson*, 473 A.2d at 812.

39. *Id.*

40. See *id.* at 812 & n.6 (noting that standard is less exacting than simple negligence).

41. *FDIC v. Gonzalez-Gorrondona*, 833 F. Supp. 1545, 1556 (S.D. Fla. 1993) (noting Florida legislature permits liability only for acts constituting more than gross negligence).

42. *Aronson*, 473 A.2d at 813 (noting that BJR may protect conscious decision to refrain from action).

When the BJR's presumption applies, courts look only to whether the requisite procedural requirements were met and do not turn to the substance of the decision.⁴³ For example, in *Auerbach v. Bennett*⁴⁴ the board of directors convened a special committee to investigate a derivative action.⁴⁵ The board decided to terminate the derivative action based on the committee's findings that the continued pursuit of the litigation was not in the best interest of the company.⁴⁶ The court extended BJR protection to the board's decision because there was no evidence that the special committee was "interested," and the court was satisfied with the extent of the committee's investigation.⁴⁷

2. Why the Businesses Judgment Rule?

There are many practical and economic rationalizations in support of the BJR and its general charge of judicial deference to board decision making. Underlying all such rationalizations is the notion that "liability rules enforced by shareholder litigation play a relatively minor role in aligning the interests of managers with those of shareholders," and therefore imposing liability on corporate decision makers is an ineffective regulatory tool.⁴⁸ There are several reasons for this observation, put forth in both scholarship and case law: first, courts should apply a deferential standard of review to business decisions to avoid risk-averse behavior in the boardroom;⁴⁹ second, courts are ill equipped to review business decisions;⁵⁰ third, existing internal checks on director and manager behavior sufficiently reduce the need for legal liability;⁵¹ and fourth, minority shareholders have a small incentive to maximize aggregate firm value.⁵²

43. See *Auerbach v. Bennett*, 393 N.E.2d 994, 1002 (N.Y. 1979) (refusing to inquire into merits of decision, but making inquiry into quality of investigation procedures).

44. 393 N.E.2d 994 (N.Y. 1979).

45. *Auerbach*, 393 N.E.2d at 1000.

46. *Id.*

47. *Id.* at 1001-02.

48. Fischel, *supra* note 24, at 1439 (noting that broad jurisdictional adoption of BJR is evidence of limited role of liability rules); see also Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573, 573 (acknowledging lack of definitive answers to questions regarding BJR rationale).

49. Fischel, *supra* note 24, at 1439; see also Davis, *supra* note 48, at 573-78 (listing risk allocation as first of several policy considerations in support of BJR).

50. Davis, *supra* note 48, at 580-83 (addressing "expertise" and "imperfect litigation" rationales); Fischel, *supra* note 24, at 1439; see also Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982) (noting "after-the-fact litigation is a most imperfect device to evaluate corporate business decisions"); *Auerbach*, 393 N.E.2d at 1000 (noting director experience "peculiarly" qualifies them to render decisions and courts should defer).

51. Fischel, *supra* note 24, at 1442-43; see also Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375, 387-90 (1983) (noting interests of senior managers are aligned with shareholders because large percentage of wealth is tied up in corporation); Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540, 559-60 (1984) (noting executive compensation agreements link managers to firm performance).

52. Fischel, *supra* note 24, at 1442-43.

The risk allocation argument turns on the fact that shareholders are well positioned to endure risk because of their ability to diversify and invest in many firms.⁵³ Managers and directors are hired for the purpose of growing shareholder investments, which often demands that business decision makers take risks.⁵⁴ Exposing managers to liability for their business decisions will cause them to avoid risk, which is “precisely the opposite of how shareholders, the superior risk bearers, want their managers to act.”⁵⁵

Another rationale states that “business judgments are for the business experts—the directors and management—and judges and juries are ill-equipped to review them.”⁵⁶ A natural corollary to this argument is the imperfect litigation argument, which suggests that ex post review of business decisions, taking place years later, is inadequate.⁵⁷ One scholar suggested that the limited cognitive resources available to the judiciary is reason for abstention.⁵⁸ Professor Bainbridge suggests that judges, like any rational decision maker faced with complexity and ambiguity in an area with which she is largely inexperienced, will actually attempt to minimize her efforts and adopt short-hand rules.⁵⁹ Such a process cannot fairly evaluate and recreate all the factors and circumstances surrounding directors when they render their decisions and thus the BJR is necessary because it limits unfair and inefficient substantive review of a decision.⁶⁰

The internal checks rationale focuses on the futility of using legal liability to regulate manager and director behavior in light of built-in corporate controls.⁶¹ Senior management and directors generally have a considerable amount of their wealth invested in the company, which aligns their interests with those of the shareholders at large.⁶² Furthermore, because executive compensation

53. *Joy*, 692 F.2d at 885–88; Fischel, *supra* note 24, at 1442–43.

54. See *Davis*, *supra* note 48, at 574–75 (arguing that “even the most potentially profitable of business decisions” involve some sort of risk); Fischel, *supra* note 24, at 1442–43 (suggesting that “[i]f shareholders wanted to avoid risk, they could have purchased government bonds rather than shares of stock”).

55. Fischel, *supra* note 24, at 1442.

56. *Davis*, *supra* note 48, at 580–83; Fischel, *supra* note 24, at 1439.

57. *Joy*, 692 F.2d at 886 (noting that circumstances surrounding business decisions are not easily reconstructed in light of need for speedy decision based on less than optimal information). *But see Smith v. Van Gorkom*, 488 A.2d 858, 880 (Del. 1985) (finding gross negligence because board approval of merger involving offer over double share price was not product of informed business judgment), *overruled by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). Delaware courts have considerably retreated from the less deferential standard of review. See *Emerald Partners v. Berlin*, 787 A.2d 85, 90–92 (Del. 2001) (discussing judicial and legislative response to *Van Gorkom*).

58. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 118–20 (2004).

59. *Id.* Professor Bainbridge admits that this is an incomplete argument for application of the BJR and offers several other rationalizations in support of his thesis that courts should use the BJR as reason to abstain from reviewing business decisions not tainted by self-dealing and fraud. *Id.* at 120–24.

60. *Joy*, 692 F.2d at 886.

61. See *supra* note 51 for sources discussing the internal checks rationale.

62. Demsetz, *supra* note 51, at 387–90; see also Donald C. Langevoort, *Resetting the Corporate*

agreements typically link compensation to firm performance, there exists a sufficient market-based incentive to ensure diligent and thorough decision making.⁶³ Finally, career mobility and job security, which depend on the success of the firm, will motivate managers and perhaps directors as well, to make good decisions in the best interest of the company.⁶⁴ Imposition of liability rules on management and directors is unnecessary and inefficient, making the BJR's deferential approach appropriate.⁶⁵

Lastly, the fact that minority shareholders have a weak incentive to maximize the value of the company relative to directors and managers suggests that courts should use a standard of review that places a considerable burden on the complaining minority.⁶⁶ Although minority shareholders have little power to "thwart the will of the majority," they are not disadvantaged because they too benefit by placing decision-making authority within the hands of the most invested.⁶⁷ With a small stake in the firm, a complaining minority shareholder will have little incentive to consider the adverse consequences for shareholders as a class, namely, the likely possibility that manager and director behavior will tend toward risk aversion.⁶⁸

B. *Business Judgment Rule Application in Residential Community Associations*

In the context of residential community associations, a minority of jurisdictions apply the BJR when reviewing disputes brought by association members against association board action, while the majority use a reasonableness standard.⁶⁹ In either case, courts acknowledge the unique environment of community associations and attempt to follow a standard of review suited to address their unique problems.⁷⁰ Part II.B.1 first discusses the

Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls, 93 GEO. L.J. 285, 295-96 (2004) (noting that corporate officers are motivated by equity incentives).

63. Fischel, *supra* note 24, at 1442-43.

64. *Id.* (noting that pervasive internal and third-party monitoring of manager and director conduct safeguards shareholders from poor decision making). *But see generally* David A. Hoffman, *Self-Handicapping and Managers' Duty of Care*, 42 WAKE FOREST L. REV. 803 (2007) (discussing legal implications on duty of care of executive self-handicapping to preserve elite position in firm).

65. Fischel, *supra* note 24, at 1442-44 (concluding that role of contract and market mechanisms reward good and penalize inferior business behavior).

66. *Id.* at 1443-44 (noting that one-share-one-vote ensures that those with most at stake control corporate decision making). This theory of course addresses only those claims and actions instituted by minority shareholders.

67. *Id.* at 1443 (citing Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983)).

68. *Id.*

69. *See, e.g.*, *Mulligan v. Panther Valley Prop. Owners Ass'n*, 766 A.2d 1186, 1190-91 (N.J. Super. Ct. App. Div. 2001) (discussing state of community association law around country); Arabian, *supra* note 22, at 11-12 (providing discussion of standards of review in jurisdictions and noting majority adopt reasonableness standard).

70. *See* *Hidden Harbour Estates, Inc. v. Norman*, 309 So. 2d 180, 182 (Fla. Dist. Ct. App. 1975) (discussing condominium arrangement as distinct from others in country).

emergence of the community association and its legal structure, while Parts II.B.2 and II.B.3 explore the most common disputes in the community association context. The manner in which courts apply the BJR in the residential community association context is then presented in Part II.B.4, with particular attention to the three main elements of the BJR, namely, that association boards must act within their powers, that they must act in good faith, and that boards must respect their fiduciary duties to the association. To close, Part II.B.4.d presents the prevailing rationales supporting application of the BJR in the residential community association context.

1. The Rise of the Community Association

Most community associations, such as condominiums and cooperatives, are created by a developer, not through direct agreement of neighboring real property owners.⁷¹ The developer drafts and records a declaration of covenants, together with by-laws, which serve as the governing documents of the community association and bind every unit owner upon purchase.⁷² The governing documents empower the association board to manage the community association and to impose restrictions on owners while overseeing association affairs.⁷³ The governing documents also provide for their own amendment and specify procedures that a board must follow when exercising its powers.⁷⁴ The governing documents are tantamount to a community constitution.⁷⁵

Homeownership in community associations is becoming more widespread throughout the United States, as community associations generally offer a cheaper alternative to detached homes.⁷⁶ Furthermore, because of the community nature of the arrangement, owners can rely on boards to handle some of the typical obligations of homeownership, such as “maintenance, roof repair, [and] lawn mowing.”⁷⁷ With these benefits, however, come inconveniences, such as limited control over the expenditure of funds⁷⁸ and the

71. Stewart E. Sterk, *Minority Protection in Residential Private Governments*, 77 B.U. L. REV. 273, 277 (1997).

72. *Id.* (citing WAYNE S. HYATT, *CONDOMINIUM AND HOMEOWNER ASSOCIATION PRACTICE: COMMUNITY ASSOCIATION LAW* 355–62 (2d ed. 1988)). Further, because the declaration is recorded, all purchasers are at least on constructive notice. Carl B. Kress, *Beyond Nahrstedt: Reviewing Restrictions Governing Life in a Property Owner Association*, 42 UCLA L. REV. 837, 840 (1995).

73. Sterk, *supra* note 71, at 277.

74. *Id.* at 277–78.

75. Kress, *supra* note 72, at 840.

76. *Id.* at 839. See *supra* note 1 and accompanying text for a discussion of community association growth.

77. Kress, *supra* note 72, at 839.

78. For example, if a board decides to replace the exterior walls of a building, which requires a special assessment of the membership, an owner who otherwise might have waited until a more financially secure time to do the work would have to contribute her proportionate share nonetheless. See Randolph C. Gwirtzman, Note, *An Exception to the Levandusky Business Judgment Rule: Owner and Shareholder Interests in Condominium and Cooperative Board Decisions*, 14 CARDOZO L. REV. 1021, 1043 (1993) (discussing how board decision to allocate budget for building-related modifications should receive greater scrutiny by courts).

presence of various use restrictions and regulations both within the home and in common spaces.⁷⁹ Disputes arise between homeowners and the associations that govern them, and courts have struggled to adopt the proper judicial framework with which to address them.

2. Disputes in Community Associations

Disputes arising out of residential community associations generally fall into one of two categories. The first category of disputes turns on whether a board action is beyond the scope of its power from a procedural or contractual perspective, as defined and limited in the governing documents and by applicable state and federal laws.⁸⁰ A board must act within the scope of its powers to realize protection of the BJR and thus many community association disputes in BJR jurisdictions revolve around this question.⁸¹

The second category of disputes concern challenges to the subject matter and substance of the rule itself.⁸² Many of the substantive disputes concern rules that result in a redistribution of market value from one group of units to another.⁸³ These sorts of disputes are common in mixed-use community associations where there is a distinct minority class.⁸⁴ Other disputes concern rules that deprive unit owners of idiosyncratic value—rules that prevent unit owners from indulging their personal tastes.⁸⁵ Courts generally enforce these rules due to the subjective nature of the unit owners' complaints.⁸⁶

3. Competing Interests in Community Associations

There are competing interests in community associations between the individual homeowner's autonomy and the need to ensure the smooth functioning of a common interest community.⁸⁷ Unit owners must cede some of their personal autonomy to the association to facilitate the functioning of the community as a whole.⁸⁸ But courts acknowledge the potential for a board to abuse its power under the governing documents and aim to protect individual

79. Kress, *supra* note 72, at 839–40.

80. Sterk, *supra* note 71, at 282–83.

81. See *infra* Part II.B.4 for a discussion of the application of the BJR in the community association context.

82. Sterk, *supra* note 71, at 284.

83. *Id.* at 320–22.

84. See *infra* Part II.D for a discussion of mixed-use community associations and disputes related thereto.

85. See, e.g., *O'Buck v. Cottonwood Vill. Condo. Ass'n, Inc.*, 750 P.2d 813, 814, 820 (Alaska 1988) (holding community association could ban TV antennae even though unit owner placed considerable value in availability of TV programming).

86. See Sterk, *supra* note 71, at 282–83 (describing cases where association regulations outside scope of covenant were upheld over objections of some owners).

87. Jeffrey A. Goldberg, Note, *Community Association Use Restrictions: Applying the Business Judgment Doctrine*, 64 CHI.-KENT L. REV. 653, 672–73 (1988).

88. *Id.*

unit owners from boards that enact and enforce rules and regulations through “arbitrary and malicious decisionmaking, favoritism, [and] discrimination.”⁸⁹

Because of the purpose of community associations, which as one scholar points out, is to “enhance the value, desirability and attractiveness of the community,” courts generally enforce association regulations.⁹⁰ Some commentators consider enforcement of association rules and regulations necessary to ensure a stable planned environment and to protect the reliance interests of unit owners who paid a premium for a particular regulatory scheme.⁹¹

4. The Business Judgment Rule as a Standard of Review in Community Association Disputes

A minority of jurisdictions use the BJR as the standard of review for community association disputes.⁹² Such jurisdictions find the analogy of the community association with a corporation persuasive and relate actions of unit owners to derivative actions of shareholders.⁹³

Like the BJR in the corporate context, in community associations the BJR functions in large part procedurally, as its primary focus is on the process of rule making rather than the substance of the rule or regulation itself.⁹⁴ In general, the BJR, like in the corporate context, prevents courts from reaching the merits of claims, and from substituting their judgment or the judgment of unit owners for that of the board.⁹⁵

To ensure BJR protection in the community association setting, like in the corporate context, a board’s action must be (1) authorized under the governing documents or under state or federal law, (2) in good faith and in a legitimate relationship to the welfare of the community association, and (3) in line with its fiduciary obligations to unit owners.⁹⁶ Procedurally, the burden is on the complaining unit owner to allege that the board failed to satisfy at least one of

89. *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1320–22 (N.Y. 1990); *see also id.* at 1320–22 (discussing competing interests involved in community association disputes); Goldberg, *supra* note 87, at 672 (noting that decisional law reflects judicial concern for individual unit owners).

90. Goldberg, *supra* note 87, at 676; *see also* Sterk, *supra* note 71, at 279–81 (discussing courts’ general tendency to enforce covenants and use restrictions contained in condominium association declarations).

91. Note, *Judicial Review of Condominium Rulemaking*, 94 HARV. L. REV. 647, 652–53 (1981) (stating that individuals purchase homes in reliance on promised condominium environment, and providing example of elderly homeowners in retirement condominiums who have interest that children will not move into other units).

92. *Cf. Mulligan v. Panther Valley Prop. Owners Ass’n*, 766 A.2d 1186, 1191 (N.J. Super. Ct. App. Div. 2001) (noting that majority of jurisdictions apply reasonableness standard).

93. Note, *supra* note 91, at 663–64.

94. *Id.* at 666.

95. VINCENT DI LORENZO, *NEW YORK CONDOMINIUM AND COOPERATIVE LAW* § 12:2, at 208 (2d ed. 1995, supp. 2007–2008).

96. *Id.* § 12:3, at 212–13.

the aforementioned requirements.⁹⁷ If the unit owner makes the allegation, the board may justify its action with clear evidence.⁹⁸ If the court is not satisfied with the unit owner's arguments for disregarding the BJR, it will dismiss the claim without reaching the substance of the board's rule.⁹⁹

a. Board Action Within Its Power Receives BJR Protection

A board that acts within the scope of its power can expect to receive the BJR's protection.¹⁰⁰ Alternatively, when a board acts outside the scope of its power, such as by breaching a contract, BJR protection is unavailable.¹⁰¹ In *Rywalt v. Writer Corp.*¹⁰² the Colorado Court of Appeals upheld a board's decision to build a second tennis court where the unit owner alleged that the governing documents failed to grant the requisite authority to the board.¹⁰³ Ignoring the trial court's extensive findings of fact,¹⁰⁴ the court conducted a strict interpretation of the governing documents, noted that all management power was vested in the board, and dismissed the plaintiffs' claims.¹⁰⁵ To justify its holding, the court relied on traditional corporate business authority and stated:

[G]ood faith acts of directors of profit or non-profit corporations which are within the powers of the corporation and within the exercise of an honest business judgment are valid. Courts will not, at the instance of stockholders or otherwise, interfere with or regulate the conduct of the directors in the reasonable and honest exercise of their judgment and duties.¹⁰⁶

The Colorado Court of Appeals in *Colorado Homes, Ltd. v. Loerch-Wilson*¹⁰⁷ reinforced and arguably extended the holding in *Rywalt* by affording BJR protection to a board that failed to enforce a covenant in a timely manner in violation of the governing documents.¹⁰⁸ The plaintiff alleged that the board's

97. *Id.* § 12:3, at 213.

98. *Id.* (citing *Cooper v. Greenbriar Owners Corp.*, 657 N.Y.S.2d 994, 994 (N.Y. App. Div. 1997)).

99. *Id.*

100. See DI LORENZO, *supra* note 95, § 12:3, at 213 (noting BJR does not apply if board acts outside scope of its authority).

101. See, e.g., *Whalen v. 50 Sutton Place S. Owners, Inc.*, 714 N.Y.S.2d 269, 271 (N.Y. App. Div. 2000) (rejecting cooperative's claim that breach of contract was protected by BJR); *Business Judgment Rule Does Not Shield Board from Breach of Contract Claim*, N.Y. REAL EST. L. REP., July 2004, at 4, 4 (addressing New York state court holding that BJR is not applicable when unit owner sues cooperative board for breach of contract).

102. 526 P.2d 316 (Colo. Ct. App. 1974).

103. *Rywalt*, 526 P.2d at 317.

104. The trial court found that there were incomplete minutes of meetings, the board used annual meetings only for purposes of electing board members, all board meetings were closed, the board did not submit proposals to the architectural control committee, the board poorly prioritized capital projects, and the board never sought a membership poll. *Id.*

105. *Id.*

106. *Id.*

107. 43 P.3d 718 (Colo. Ct. App. 2001).

108. *Colo. Homes, Ltd.*, 43 P.3d at 723–24.

failure to enforce the use restriction was a breach of contract, but the court nonetheless afforded BJR protection.¹⁰⁹ The court found that the relational nature of the contract implied considerable board discretion with respect to the manner and timing of the enforcement of the restriction against a unit owner and was therefore a decision subject to BJR protection.¹¹⁰

b. Board Action Must Be in Good Faith and Bear a Relationship to the Welfare of the Association

To receive BJR protection, a board must act in good faith, which courts define as any action bearing a legitimate relationship to furthering community association purposes.¹¹¹ Because boards can easily establish some tangential relation to community purposes, a finding of bad faith may turn on whether a board action is the result of a personal vendetta against a unit owner.¹¹² In *Y & O Holdings (NY), Inc. v. Board of Managers of Executive Plaza Condominium*,¹¹³ the board enacted a rule prohibiting occupancy by short-term renters.¹¹⁴ The board enacted the rule only one month after the plaintiff, owner of forty short-term rental units, terminated her brokerage contract with the association's management agent.¹¹⁵ Because the plaintiff alleged that the management agent threatened individual board members to enact the rule, the court found sufficient evidence of bad faith to deny the association's motion for summary judgment.¹¹⁶

The pioneer case adopting the BJR in New York, *Levandusky v. One Fifth Avenue Apartment Corp.*,¹¹⁷ suggests that establishing bad faith might not be as easy as *Y & O Holdings (NY), Inc.* notes. In *Levandusky*, the plaintiff was a unit owner who changed the location of a steam pipe in his kitchen even though the board had denied his request.¹¹⁸ Although the plaintiff sought an opinion from a professional engineer and alleged that the board singled his unit out from others,¹¹⁹ the court refused to consider the possibility of bad faith and extended BJR protection.¹²⁰

109. *Id.* at 720–721, 723–24.

110. *Id.* at 723–24.

111. DI LORENZO, *supra* note 95, § 12:3, at 216.

112. *See, e.g., id.* (citing *Boisson v. 4 E. Hous. Corp.*, 514 N.Y.S.2d 374, 375 (N.Y. App. Div. 1987)).

113. 717 N.Y.S.2d 602 (N.Y. App. Div. 2000).

114. *Y & O Holdings (NY), Inc.*, 717 N.Y.S.2d at 603.

115. *Id.*

116. *Id.*

117. 553 N.E.2d 1317 (N.Y. 1990).

118. The governing documents required board approval for any pipe alteration in individual units. *Levandusky*, 553 N.E.2d at 1319.

119. *Id.* at 1323 (noting that board permitted several other unit owners to move their steam pipe risers).

120. *Id.*

c. *Breach of Fiduciary Duty*

To receive BJR protection, a board or association must not breach its fiduciary duties to the unit owners.¹²¹ The fiduciary duty of an association board consists of three elements: (1) the duty of loyalty, (2) the duty to treat all unit owners fairly and evenly, and (3) the duty of care.¹²² The duty of loyalty requires board members to act for the benefit of the association and not out of personal self-interest.¹²³ The duty to treat all unit owners fairly and evenly is most prominent in the mixed-use context where there is a distinct minority group.¹²⁴ Finally, the duty of care reinforces the common theme that board members must inform themselves of relevant material information when making decisions that affect the lives of unit members.¹²⁵

The fiduciary duty requirement is well illustrated by *Lyman v. Boonin*,¹²⁶ in which the court applied the BJR¹²⁷ to a claim challenging a policy that gave resident unit owners priority for parking spaces.¹²⁸ Noting that the board was comprised 100% of residential owners, the court denied summary judgment for the board because of the strong suggestion of self-dealing.¹²⁹ Describing self-dealing, the court observed, “there must be a demonstration of a benefit that was gained at the expense of imposing an *impermissible* burden on the other owners.”¹³⁰ The court acknowledged that a board can validly favor one group over another, but noted that a policy that forces a group of owners to subsidize an item of expense with no corresponding benefit could be grounds for invalidation.¹³¹

121. DI LORENZO, *supra* note 95, § 12:3, at 217; *see also* *Lyman v. Boonin*, 635 A.2d 1029, 1031–32 (Pa. 1993) (holding that board actions constituting self-dealing are not protected by BJR).

122. DI LORENZO, *supra* note 95, § 12:3, at 217–19.

123. *Id.* § 12:3, at 217.

124. *See infra* Part II.D.2.c for a detailed discussion of the duty to treat all unit owners fairly.

125. DI LORENZO, *supra* note 95, § 12:3, at 219.

126. 635 A.2d 1029 (Pa. 1993).

127. *See Lyman*, 635 A.2d at 1032 (holding that judicial relief will be granted where plaintiff establishes that board action is “unauthorized,” or “taken fraudulently, in bad faith, or constituted self-dealing”). Pennsylvania’s Uniform Condominium Act, 68 PA. CONS. STAT. § 5303 (2007), now requires Pennsylvania courts to review board action using a reasonableness standard rather than the BJR. *Burgoyne v. Pinecrest Cmty. Ass’n*, 924 A.2d 675, 683 (Pa. Super. Ct. 2007). *Lyman* predates the statute and is a good illustration of BJR application.

128. *Lyman*, 635 A.2d at 1030 n.1 (noting that condominium has 776 residential units but only 325 parking spaces). The board consisted solely of residential unit owners because nonresidents were not permitted to serve. *Id.* at 1030.

129. *Id.* at 1032–33 (noting that material issue of fact existed with respect to finding of self-dealing).

130. *Id.* at 1032 n.7 (emphasis added).

131. *Id.* at 1032–33 (noting that facially discriminatory action could be valid but not where financial obligations are imposed and no corresponding benefit is received).

d. Prevailing Rationales for the BJR in Community Associations

Because the BJR is a borrowed doctrine from corporate law, courts and scholars offer many of the same rationalizations to support its application in the context of community associations.¹³² Four rationalizations are consistent throughout community association case law and scholarship: (1) the voluntary and contractual nature of community association members militates in favor of less judicial intervention (“the contract view”),¹³³ (2) the BJR limits frivolous litigation and provides predictable guidelines to community boards,¹³⁴ (3) boards are in a better position than courts to make decisions concerning their buildings and communities,¹³⁵ and (4) the interests of those not on the board are adequately represented by board members who share similar interests.¹³⁶

The contract view supporting the BJR application in community associations is well developed throughout the case law and scholarship. Courts and scholars reason that because membership in community associations is purely voluntary, courts should defer to the board, which has the power vested in it by virtue of the governing documents.¹³⁷ The *Levandusky* court noted that “there is always the freedom not to purchase” a unit.¹³⁸ Moreover, the nature of the contract, which some scholars classify as relational, militates in favor of less judicial intervention.¹³⁹ According to the contract view, it would be impossible for the governing documents to contemplate all potential future circumstances, and therefore courts should extend latitude to board decisions.¹⁴⁰ The contract rationale is also based on the notion that homeownership is typically “the largest single investment most people will make,” so there is adequate incentive for unit owners to review the governing documents prior to purchase.¹⁴¹

A second rationale for the BJR is that it limits the amount of litigation in the context of community associations.¹⁴² Because board decisions often result in

132. See Goldberg, *supra* note 87, at 664–69 (discussing BJR in context of viewing community association as corporation).

133. See, e.g., *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1320–21 (N.Y. 1990) (discussing voluntary nature of agreement to be governed by association board); Gwirtzman, *supra* note 78, at 1022–23 (noting that standard of review has been deferential because of stability established by contractual relationship).

134. See, e.g., Goldberg, *supra* note 87, at 667–68 (“The business judgment doctrine is suited to thwarting the subjective gripes of an owner who merely does not agree with the decision of the board.”).

135. *Levandusky*, 553 N.E.2d at 1322 (quoting *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979)).

136. Sterk, *supra* note 71, at 297–98 (discussing reasons for BJR).

137. *Levandusky*, 553 N.E.2d at 1320–21.

138. *Id.* at 1320.

139. *Id.* at 1321–22; see also Clayton P. Gillette, *Courts, Covenants, and Communities*, 61 U. CHI. L. REV. 1375, 1415 (1994) (noting that association agreements resemble relational contracts).

140. *Levandusky*, 553 N.E.2d at 1321–22.

141. Sterk, *supra* note 71, at 301 (citing Robert G. Natelson, *Consent, Coercion, and “Reasonableness” in Private Law: The Special Case of the Property Owners Association*, 51 OHIO ST. L.J. 41, 60–61 (1990)).

142. *Levandusky*, 553 N.E.2d at 1322–23.

“highly charged and emotional” exchanges involving multiple competing views, dissatisfied owners should not be offered every opportunity to reopen the matter before a court.¹⁴³ Permitting such unbridled litigation, the *Levandusky* court reasoned, would lead to the instability of the community.¹⁴⁴ A logical corollary to this argument is that board membership is typically uncompensated and purely voluntary.¹⁴⁵ To that end, a deferential standard of review is necessary so as not to discourage board members from serving because they fear expensive and time-consuming lawsuits.¹⁴⁶

A third rationale for BJR application is that courts are “ill-equipped” to evaluate what are essentially business judgments, a recurring theme from the corporate setting.¹⁴⁷ In *Levandusky*, the court addressed the apparent disconnect between the corporate world, where board members and managers are highly skilled, with the lay qualifications characteristic of community association boards, observing that “[e]ven if decisions of a cooperative board do not generally involve expertise beyond the usual ken of the judiciary, at the least board members will possess experience of the peculiar needs of their building and its residents not shared by the court.”¹⁴⁸ Thus, the expertise of the board members comes not from their educational or technical backgrounds, but rather from their familiarity with the building and community itself.¹⁴⁹

A fourth rationale for protecting board action with the BJR is the naturally occurring alignment of association ownership interests. In the context of residential community associations, courts that adopt the BJR standard of review believe that all residential unit owners share similar long-term goals for their unit—namely, to either maintain or grow the value of their investment.¹⁵⁰ That being the case, “standard economic behavior of cost minimization or built-in protections against inequalities,” such as those contained in the governing documents, will ensure that those members not on the board will be assured of adequate representation of their interests.¹⁵¹ Furthermore, community associations are generally comprised of similarly economically situated members, and thus “community association governance rules are unlikely engines for significant wealth redistribution.”¹⁵² Therefore, a deferential judicial approach to

143. *Id.* at 1322.

144. *Id.*; see also Goldberg, *supra* note 87, at 674 (noting reasonableness standard leaves board decisions too vulnerable to judicial second guessing).

145. See Gillette, *supra* note 139, at 1428 (noting that unlike corporate board members, association board members have little to gain financially).

146. See *id.* (discussing general lack of incentives of board service).

147. *Levandusky*, 553 N.E.2d at 1322. See *supra* Part II.A.2 for a discussion of the “ill-equipped courts” rationale in the corporate setting.

148. *Levandusky*, 553 N.E.2d at 1322.

149. *Id.*

150. See Gwartzman, *supra* note 78, at 1027 (noting economic decisions by boards will affect each unit owner equally).

151. *Id.*

152. Sterk, *supra* note 71, at 297 (critiquing various rationales for deferential review of association rule making).

board decisions such as the BJR is preferable to other standards, such as the reasonableness approach, which allows courts to substitute their judgment for that of the boards.

C. The Reasonableness Standard: A Two-Step Approach

The majority of jurisdictions apply a reasonableness standard to community association disputes.¹⁵³ Under a reasonableness review, courts take a two-step approach. First, they apply a highly deferential standard of review for disputes concerning rules and regulations contained in the governing documents themselves or in force prior to the complainant's purchase.¹⁵⁴ Second, they apply a less deferential reasonableness standard for rules not specifically mandated by the governing documents.¹⁵⁵ This approach is necessary, its proponents argue, to ensure the reliance interest of all unit members, both majority and minority alike.¹⁵⁶

1. Step One: Rules and Regulations Contained in Governing Documents and in Force Prior to Purchase Receive BJR-like Review

Courts in reasonableness jurisdictions treat rules and regulations contained in or directly implied by the governing documents as covenants running with the land.¹⁵⁷ Courts presume that such rules, regulations, and board actions are valid on the theory that unit owners are on at least constructive notice since governing documents are available for inspection prior to their purchase.¹⁵⁸ Similar to the BJR, the action is generally enforced unless the plaintiff can demonstrate that the action is “wholly arbitrary” (in BJR terms, “bad faith”), in “violation of [a sound] public policy,” or that the action, rule, or regulation “abrogate[s] some fundamental constitutional right.”¹⁵⁹ Many courts in reasonableness jurisdictions call this analysis “reasonableness review” but as the court in *Ridgely Condominium Association, Inc. v. Smyrnioudis (Ridgely I)*¹⁶⁰ noted, a rule, regulation, or board action specifically mandated by the declaration “may have a certain degree of unreasonableness to it, and yet withstand attack in the courts.”¹⁶¹ Enforcement of such restrictions is necessary, reasonableness courts

153. See *supra* note 69 and accompanying text for a discussion of prevailing community association case law.

154. *Nahrstedt v. Lakeside Vill. Condo. Ass'n, Inc.*, 878 P.2d 1275, 1284 (Cal. 1994) (in bank).

155. *Id.*

156. *Id.*

157. See, e.g., *Ridgely Condo. Ass'n, Inc. v. Smyrnioudis (Ridgely I)*, 660 A.2d 942, 947 (Md. Ct. Spec. App. 1995) (citing *Hidden Harbour Estates, Inc. v. Basso*, 393 So. 2d 637, 639–40 (Fla. Dist. Ct. App. 1981)) (discussing restrictions contained in governing documents).

158. *Id.* at 948.

159. *Id.* at 947 (quoting *Hidden Harbour*, 393 So. 2d at 639–40).

160. 660 A.2d 942 (Md. Ct. Spec. App. 1995).

161. *Ridgely I*, 660 A.2d at 947 (quoting *Hidden Harbour*, 393 So. 2d at 640).

claim, to protect the reliance interest of buyers who pay a premium for a community's restrictive scheme.¹⁶²

2. Step Two: Rules and Regulations Not Specifically Mandated by Declaration and Enacted After Purchase Receive Reasonableness Review

Imposing a reasonableness standard on board or association action not specifically mandated in the governing documents causes association boards to exercise caution. Freed from the bounds of the BJR's process-based approach, a court will reach the substance of the disputed action if the action involves the enactment of a new rule or policy after the complainant purchased her unit. The standard, reasonableness courts claim, forces boards to enact rules and regulations that "reasonably relate[] to the promotion of the health, happiness and peace of mind of [all classes of] unit owners," not simply the majority class.¹⁶³ In *Ridgely I*, the court enunciated this goal: "The requirement of 'reasonableness' in these instances is designed to somewhat fetter the discretion of the board of directors."¹⁶⁴

D. *Mixed-Use Community Associations*

While much scholarship and case law exists in the context of residential community associations, there is little dealing specifically with mixed-use community associations. Mixed-use community associations present very different structural and conceptual problems than community associations comprised solely of residential units. Nonetheless, mixed-use projects are becoming more and more popular because of the "increasing scarcity of land, urban revitalization, and the increased focus on smart growth."¹⁶⁵

A mixed-use community can be comprised of residential, commercial, and sometimes even lodging or hotel units.¹⁶⁶ Within mixed-use communities, there is a diverse range of competing interests.¹⁶⁷ For example, residential homeowners typically have an interest in growing the value of their home investment, but they also seek to ensure that their living space is peaceful, safe, and free of unnecessary disruption with limited public access.¹⁶⁸ Commercial unit owners also seek to grow the value of their investment, but they typically seek unrestricted public access to their stores.¹⁶⁹ Further, commercial unit owners

162. *Nahrstedt v. Lakeside Vill. Condo. Ass'n, Inc.*, 878 P.2d 1275, 1284 (Cal. 1994) (in bank).

163. *Ridgely I*, 660 A.2d at 948 (quoting *Hidden Harbour*, 393 So. 2d at 640).

164. *Id.* (citing *Hidden Harbour*, 393 So. 2d at 640).

165. Winston, *supra* note 2, at 1.

166. Bernard Meyer, *Understanding the Mixed Use Association*, ASS'N TIMES, Jan. 2005, <http://www.associationtimes.com/articles2005/mixeduse0105.htm>.

167. *Id.*

168. *Id.*; see also Gwirtzman, *supra* note 78, at 1038-41 (addressing habitat issues within residential community associations as distinct from economic issues of association).

169. See Meyer, *supra* note 166 (discussing competition between homeowners and commercial interests).

have location-specific concerns linked to the goodwill value of their business¹⁷⁰ and tend to seek predictable property assets to maximize investment and financing potential.¹⁷¹

1. The Mixed-Use Challenge and Practitioners' Practical Solution

Cognizant of the potential for problems within a mixed-use community, lawyers typically advise residential and commercial owners to use caution when purchasing their units.¹⁷² Upon inspection, residential buyers may find that the governing documents place much of the decision-making power in the hands of the commercial units, or, alternatively, commercial units might be subject to the will of association boards, comprised largely of homeowners with whom they have very little in common.¹⁷³ A common theme in the case law is that community association boards comprised largely of residential unit owners often disapprove of and reject proposed uses of retail space, such as proposals for sidewalk sales, signage, and extended store hours.¹⁷⁴ Control in this way can significantly decrease the market value of a commercial unit, making it difficult for potential purchasers to obtain adequate financing.¹⁷⁵

Modern developers, eager to lure commercial business to their projects, are beginning to include reservation language in the governing documents permitting any lawful commercial retail purpose.¹⁷⁶ Some practitioners now use other structural-based solutions to help mitigate sharing problems between

170. As opposed to residential unit owners, commercial unit owners must consider the value of their business that is tied solely to location. *See, e.g.*, *N. Clackamas Cmty. Hosp. v. Harris*, 664 F.2d 701, 704 (9th Cir. 1980) (noting that goodwill is asset that figures significantly in valuation of business); *Didlake v. Roden Grocery Co.*, 49 So. 384, 386 (Alaska 1909) (defining goodwill of business as customers' propensity to return to specific location); *Slate Co. v. Bikash*, 177 N.E.2d 780, 782 (Mass. 1961) (noting that business's goodwill included location, which enabled customer retention); *Murray v. Bateman*, 51 N.E.2d 954, 955 (Mass. 1943) (noting that goodwill results when name, location, and reputation give advantages which allow businesses to retain customers); *Maitland v. Slutsky*, 275 N.W. 726, 728 (Mich. 1937) (noting that "[g]ood will may be attached to the particular place where the business is conducted" but that it is not "necessarily dependent upon locality"); *Roth v. Roth*, 406 N.W.2d 77, 80 (Minn. Ct. App. 1987) (defining goodwill as amount buyer would pay for going concern above book value of assets); *Dugan v. Dugan*, 457 A.2d 1, 4-5 (N.J. 1983) (holding that goodwill is necessarily attached to going business, is related to name, location, and reputation, and tends to enable business to retain patronage); *Nashville Prods., Inc. v. Flats Waterfront Assocs.*, 699 N.E.2d 955, 958 (Ohio Ct. App. 1997) (noting that goodwill of business does not "automatically attach[] to the real property where the business itself is being conducted").

171. J. Christopher Kinsman, *Forming the Mixed-Use Community: How to Avoid the Pitfalls of Sharing*, COLO. REAL EST. J., June 20, 2007, available at <http://www.fwlaw.com/Resources/Articles/RealEstateArticles/FormingtheMixedUseCommunity/tabid/235/Default.aspx>.

172. *Id.*; Meyer, *supra* note 166.

173. Meyer, *supra* note 166.

174. Scott E. Mollen, *Realty Law Digest*, N.Y.L.J., Mar. 30, 2005, at 5.

175. *Id.* ("Lenders do not want to lend money on properties that may remain vacant while an owner fights with a board over a proposed use.")

176. *Id.* (discussing trend to include reservation language in governing documents).

various classes of unit owners, such as the use of cross easements,¹⁷⁷ separate associations,¹⁷⁸ and the creation of separate voting classes.¹⁷⁹

2. Disputes in Mixed-Use Communities—The BJR Versus the Reasonableness Standard

Even though there are competing interests at stake in mixed-use community associations that are not present in purely residential communities, courts apply the standard of judicial review uniformly in BJR jurisdictions.¹⁸⁰ In reasonableness jurisdictions, however, some courts recognize the need for a more tailored judicial approach to the mixed-use community.¹⁸¹ A considerable number of the disputes in the mixed-use context center on whether an assessment scheme implemented by the board is within the scope of its powers, whether the action bears a legitimate relation to the well-being of the community (i.e., whether the act was taken in bad faith), or whether a particular regulation results in a justifiable redistribution of market value.

a. Assessment Schemes—Charging for Uncommon Elements

In *Board of Managers of the 229 Condominium v. J.P.S. Realty Co.*¹⁸² the board sued a commercial unit owner who withheld assessment payments for elements that she claimed were uncommon and only pertained to residential units.¹⁸³ Applying the BJR, the trial court first granted summary judgment for the condominium, holding that the board's allocation of common charges and special assessments were subject to BJR protection and the broad power granted to the board by the governing documents shielded the substance of the decision

177. Cross easements can work when residential and commercial units are on separate legal parcels and create stable and predictable relationships. Kinsman, *supra* note 171. As Kinsman notes, such easements may frustrate long term coexistence because of their inflexible nature in light of the relational contracts governing community associations. *Id.*

178. The master association governs only those truly common elements of the community while separate associations regulate all other matters unique to the residential and commercial interests. *Id.* The problem, however, is such multi-association communities can become very complex. See Terry Sheridan, *Mixed-Use Unit Owners in for Surprise*, PALM BEACH DAILY BUS. REV., June 30, 2005 (noting that shared elements such as lobbies can be held in master association with boards comprised equally of residential and commercial, regardless of proportionate share of community).

179. Creation of separate voting classes can be used where there is a large imbalance of commercial and residential units. Kinsman, *supra* note 171.

180. See *infra* Part III.A.1–2 for a discussion of the uniform application of the BJR across mixed-use and purely residential communities.

181. See, e.g., *Ridgely Condo. Ass'n, Inc. v. Smyrnioudis (Ridgely I)*, 660 A.2d 942, 950 (Md. Ct. Spec. App. 1995) (noting that where minority interests compete with majority interests in community association, judicial deference to board action is inappropriate). See *infra* Part III.B for a discussion of the *Ridgely I* court's reasoning.

182. 764 N.Y.S.2d 405 (N.Y. App. Div. 2003).

183. *Bd. of Managers of the 229 Condo.*, 764 N.Y.S.2d at 406–07. The condominium at issue was comprised of four commercial units making up eight percent interest in the common elements, two professional units making up three percent, and fifty apartments constituting eighty-nine percent. *Id.* at 406.

from judicial review.¹⁸⁴ The appellate court ordered the trial court on remand to conduct a strict contract analysis to determine whether each assessment was considered “common” pursuant to the terms of the governing documents.¹⁸⁵ The appellate court dismissed the commercial unit owner’s argument that the BJR was inapplicable in light of the “inherent conflict of interest with regard to the residential” unit dominance of the board, all of whom benefited at the expense of the commercial owners.¹⁸⁶

The Massachusetts Appellate Court applied a reasonableness standard to a similar set of facts in *Blood v. Edgar’s, Inc.*¹⁸⁷ In *Blood*, the condominium board rolled a residential rental program into the common elements of the association, obligating commercial unit owners to contribute.¹⁸⁸ Noting that the rental program was not in place at the time of original purchase, the court held that the commercial unit owner was entitled to have her reasonable expectations at the time of purchase enforced.¹⁸⁹ Unlike many other shared elements, such as roofs, walkways, and utility rooms, the rental program benefited only residential owners and thus the court determined that its inclusion in common elements was unreasonable in light of the commercial unit owner’s reliance interest.¹⁹⁰

b. Regulations Resulting in Redistribution of Market Value

Another fertile ground for disputes in mixed-use associations arises when a board makes a decision that redistributes market value from one category of units to others.¹⁹¹ Many associations that pass such rules do so under the cover of some allegedly legitimate community purpose.¹⁹² The case of *Ridgely Condominium Association, Inc. v. Smyrnioudis (Ridgely II)*,¹⁹³ from Maryland, a reasonableness jurisdiction, provides a good example. The condominium building in *Ridgely II* was comprised of 239 units, seven of which were commercial while all the others were residential.¹⁹⁴ The commercial units were accessible both through the condominium lobby as well as through the storefronts facing the adjacent street.¹⁹⁵ Because the association was experiencing security problems that it attributed, in part, to commercial traffic through the lobby, the membership voted to amend the by-laws to prohibit lobby

184. *Id.* at 407.

185. *Id.* at 408.

186. *Id.*

187. 632 N.E.2d 419 (Mass. App. Ct. 1994).

188. *Blood*, 632 N.E.2d at 420–21.

189. *Id.* at 423.

190. *Id.*

191. See Sterk, *supra* note 71, at 285–86 (noting that association majorities often implement rules increasing value of many at expense of few).

192. *Id.*

193. 681 A.2d 494 (Md. 1996).

194. *Ridgely II*, 681 A.2d at 496.

195. *Id.*

use by commercial customers.¹⁹⁶ The commercial unit owners brought an action “seeking to enjoin the enactment [and] enforcement of [the rule].”¹⁹⁷

The trial court and the Special Appeals Court both conducted a reasonableness examination of the rule and found that it was unenforceable because it did not “reasonably relate to the health, happiness and enjoyment of unit owners.”¹⁹⁸ Acknowledging that safety concerns did give rise to the rule, and thus the appearance of legitimacy was present, the trial court found that there were no significant factual findings to substantiate the board’s determination that the security problem was, in fact, caused by commercial traffic.¹⁹⁹ Moreover, under the reasonableness standard, the trial court held that the blanket use restriction was not the “least intrusive method, or the best means available” to obtain more secure premises in light of the commercial unit owners’ significant economic interest in offering lobby access for their customers.²⁰⁰ Acknowledging the soundness of the lower court’s reasonableness analysis, the court of appeals, *sua sponte*, rejected the use restriction based on a traditional real property analysis.²⁰¹ The appeals court treated the lobby use restriction as an impermissible taking of the commercial unit owners’ interest in property appurtenant to their units.²⁰²

c. Bad Faith and Fiduciary Duty in Mixed-Use Rule Making

To avoid BJR protection, commercial unit owners in mixed-use communities challenge board decisions on the grounds of bad faith and breach of the fiduciary duty to treat all owners fairly and evenly. In *Louis & Anne Abrons Foundation, Inc. v. 29 E. 64th Street Corp.*²⁰³ the plaintiff commenced an action seeking a declaratory judgment that an enacted sublet fee affecting only commercial units was null and void.²⁰⁴ Because a use restriction prohibiting residential subleases was in place at the time the board instituted the sublet fee, the court concluded that there was a material issue of fact as to whether the board acted in bad faith.²⁰⁵ Reversing the trial court’s grant of summary judgment for the condominium association, the court held that a cooperative must treat its members “fairly and evenly,” and “[a]ny departure from uniform

196. *Id.* at 497.

197. *Id.*

198. *Id.* at 498 (internal quotation marks omitted).

199. *Ridgely II*, 681 A.2d at 498.

200. *Id.* (internal quotation marks omitted).

201. *Id.* at 498–501.

202. *Id.* No BJR jurisdiction seems to have adopted this real-property approach in reviewing community association use restrictions.

203. 746 N.Y.S.2d 482 (N.Y. App. Div. 2002).

204. *Louis & Anne Abrons Found.*, 746 N.Y.S.2d at 483. The mixed-use condominium at issue was comprised of forty-three residential units while the ground floor was comprised of seven commercial units owned by the plaintiff. *Id.* at 482–83.

205. *Id.* at 484 (noting rule had discriminatory effect despite appearance of neutrality).

treatment of shareholders must be in furtherance of a justifiable and bonafide business purpose.”²⁰⁶

Another case brought by a commercial owner in a mixed-use community involving claims of bad faith and breach of the fiduciary duty to treat all unit owners fairly and evenly is *Schultz v. 400 Cooperative Corp.*²⁰⁷ In *Schultz*, the plaintiff, a psychotherapist, purchased her commercial cooperative unit to use as her office and residence subject to a \$300 monthly professional fee.²⁰⁸ After the first year, the plaintiff negotiated with the cooperative board to replace the fee with an increased allocation of shares to her unit, which would result in a greater responsibility for common area charges.²⁰⁹ After the plaintiff retired and converted her unit back to residential purposes ten years later, she asked the board to remove the increased allocation.²¹⁰ When the board refused, the plaintiff sued, claiming that the allocation scheme forced commercial units to pay a disproportionate share of the common area charges.²¹¹ The trial court denied BJR protection because it found discrimination against the commercial units, however, the appellate court reversed.²¹² Because the rule affected all commercial units equally, the court determined that there was no harmful treatment and stated that “the [BJR] insulates the board’s exercise of its managerial prerogative from plaintiffs’ indiscriminate attack.”²¹³

Mixed-use community associations present a perfect storm of competing interests, and as the next Part demonstrates, the BJR is insufficient to adequately resolve disputes while respecting the reliance interests of all unit owners forced to coexist in the community.

III. DISCUSSION

The divergent interests within a mixed-use community association, and the resulting propensity for disputes, suggest that the highly deferential BJR standard of review is inappropriate. BJR jurisdictions copied the doctrine from corporate law, where it developed for good reason, and pasted it into a community setting, where almost none of the underlying rationales apply. Even assuming that the BJR has some application within the purely residential

206. *Id.* (quoting *Smolinsky v. 46 Rampasture Owners, Inc.*, 646 N.Y.S.2d 110, 112 (N.Y. App. Div. 1996)). The court further provided that the BJR permits review of a decision when a board’s action deliberately singles out an individual for harmful treatment. *Id.*

207. 736 N.Y.S.2d 9 (N.Y. App. Div. 2002).

208. *Schultz*, 736 N.Y.S.2d at 10.

209. *Id.*

210. In connection with that effort, the plaintiff incurred considerable expense to amend her certificate of occupancy, in accordance with co-op policy. *Id.* at 11.

211. *Id.*

212. *Id.* at 14.

213. *Schultz*, 736 N.Y.S.2d at 14 (citing *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1317 (N.Y. 1990)). In addition to the court’s BJR argument, it reversed on contract grounds as well, finding that the board was under no obligation to “absorb the financial impact of plaintiffs’ exercise of [her option to convert to residential use] by reducing monthly maintenance charges through a downward revision in the shares allocated to their unit.” *Id.* at 13.

context, the context for which it was initially borrowed, its reach should not extend to mixed-use projects. BJR jurisdictions should recognize the unique mixed-use setting and adopt a standard of review that readily allows courts to reach the merits of nonfrivolous claims, such as the reasonableness standard. The failure to do so renders minority commercial members within a community association near powerless to defend their reliance interests in their properties and business investments.

The BJR in the corporate setting and the community association setting are, with some minor adjustments, roughly the same.²¹⁴ Courts in BJR jurisdictions apply the BJR blindly across purely residential and mixed-use cases, which is indicative of their failure to acknowledge the difference between the purely residential and the mixed-use community.²¹⁵ Moreover, the rationalizations offered in support of the BJR's application in the community association setting are by and large exactly the same as those offered in the corporate setting.²¹⁶ Each principle is improperly applied to the mixed-use association militating in favor of BJR rejection. A more appropriate judicial approach is the reasonableness standard because it allows courts to balance the competing interests at play within the complex mixed-use community.²¹⁷

A. The BJR Fails to Address the Unique Mixed-Use Community Environment and Is an Inappropriate Standard of Review

Since the BJR is a borrowed doctrine from corporate law, courts applying the doctrine in the community association context apply it in a very similar manner. Moreover, it is clear from an analysis of the case law that courts in BJR jurisdictions apply the BJR in the same manner and with the same scope in the mixed-use context as they do in the purely residential context. The problem, however, is that the rationales offered to support the BJR in both the corporate context as well as in the purely residential community association do not apply in the mixed-use setting.

1. The BJR Is Applied to Community Associations in the Same Manner and with the Same Scope as It Is in the Corporate Setting

Courts adopting the BJR in the community association context claim they do so by analogy only, but the case law suggests otherwise.²¹⁸ As in the corporate context, courts applying the BJR to community association disputes take a

214. See *infra* Part III.A.1 for a discussion of the similarities of the duty to act in good faith and corporate law's requirement of a rational basis for decisions.

215. See *infra* Part III.A.2 for a discussion of the BJR's entry into law in residential cases and its subsequent application to mixed-use cases.

216. See *infra* Part III.A.3 for detailed consideration and rejection of these rationales.

217. See *infra* Part III.B, which uses the facts from the *Ridgely* case to illustrate the ineffectiveness of the BJR to ensure the reliance interest of commercial unit owners in communities dominated by residential ownership.

218. See, e.g., *Levandusky*, 553 N.E.2d at 1321 (adopting BJR by analogy only but refusing to create special category of corporate law for community associations).

process-based approach and refuse to reach the merits or substance of claims unless the plaintiff can demonstrate that BJR protection is not warranted.²¹⁹ The BJR's scope is extremely similar in the community association context, and if anything its protection is more expansive, as the case law narrows an association board's fiduciary obligations from those of a corporate business board.²²⁰

First, the requirement that a board's action be in good faith is identical to the fiduciary obligation of corporate boards to render decisions with a rational basis.²²¹ This is perhaps the only substantive component of the BJR review, but its substance is paper-thin because the focus is on mere rationality.²²² With respect to community associations, the case law defines good faith as any action that bears a legitimate relation to community association purposes.²²³ In the corporate context, a decision must bear a rational basis to corporate purposes.²²⁴ The first requirement for BJR protection in the community association context—to act in good faith—is thus practically verbatim from corporate law and applied roughly the same way.

Second, the requirements that a board observe its duties of loyalty and care to gain protection under the BJR are similarly borrowed doctrines from corporate law, however, in the community association context, they might actually be less restrictive of board action. In the context of community associations, the duty of loyalty requires that board members be disinterested parties, i.e., it prohibits boards from self-dealing and, in theory, from discriminating against association members.²²⁵ In the corporate context, the duty of loyalty might actually be more restrictive since it can move beyond a simple prohibition against self-dealing to an affirmative duty to act exclusively for the benefit of the corporation.²²⁶ Moreover, in the corporate context, when the plaintiff properly pleads facts that suggest the possibility of a board member's conflict of interest, courts often deny BJR protection and shift the burden back to the board.²²⁷ In the community association context, the requirement is simply

219. Compare *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (referring, in corporate context, to due care as only procedural, not substantive), with *Levandusky*, 553 N.E.2d at 1326 (Titone, J., concurring) (noting that BJR review looks to decision-making process only).

220. See *infra* notes 225–28 and accompanying text for a discussion of the narrowing of fiduciary obligations. See *supra* Part II.B.4 for an analysis of an association board's duty to act within its powers, in good faith, and in accordance with its fiduciary duties.

221. See *COX & HAZEN*, *supra* note 28, § 10.05, at 194–96 (discussing rational basis test).

222. *Id.*

223. See *supra* Part II.B.4.b for a discussion of bad faith in the community association context.

224. *COX & HAZEN*, *supra* note 28, § 10.05, at 195–96 (citing *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807 (N.Y. Sup. Ct. 1976), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1976)) (noting that level of review higher than rational basis would result in risk-averse behavior).

225. *DI LORENZO*, *supra* note 95, § 12:3, at 217–18.

226. See *COX & HAZEN*, *supra* note 28, § 10.09, at 204–05 (discussing authority suggesting directors' duty of loyalty includes both positive and negative components).

227. See *Hoffman*, *supra* note 64, at 809–10 (citing *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986)) (noting that disloyal corporate managers do not receive BJR protection).

that a board cannot unfairly benefit from a transaction at the expense of the membership at large.²²⁸

The duty of care in the community association comes directly from corporate law and is applied identically with a focus on whether the board adequately informed itself prior to rendering a decision that affects association members.²²⁹ The standard of care for board members is described as gross negligence, perhaps even bordering on criminal negligence.²³⁰ Given this extremely low standard, plaintiffs are hard-pressed to successfully predicate a claim on breach of the duty to avoid BJR protection in both the corporate and the community association contexts. Similarly, failure to extend BJR protection to board action outside the scope of its powers is a requirement from corporate law, directly applied to community association law.²³¹

Perhaps the only limitation on the scope of BJR application in the community association context not expressly taken from traditional corporate law is the duty to treat all unit owners fairly and evenly.²³² However, decisional law in this area demonstrates that this provision's bark is louder than its bite. Courts applying the rule subordinate the duty to treat all unit owners fairly and evenly to the requirement to act in good faith, i.e., action that bears a legitimate relationship to community association purposes.²³³ It thus seems that as long as the board ties its action to a legitimate community purpose, it may justify imposing a rule that disproportionately affects membership classes. Moreover, in *Schultz v. 400 Cooperative Corp.*,²³⁴ the court further reduced the effect of the duty by suggesting that a board may treat ownership classes of shareholders differently by board action so long as it treats the subclass members evenly among themselves.²³⁵ Although not specifically applying a corporate-borne fiduciary obligation, *Louis & Anne Abrons Foundation, Inc. v. 29 East 64th Street Corp.*²³⁶ and *Schultz* illustrate a BJR-based judicial approach to community association disputes that illogically prohibits minority members of community associations from effectively having their claims adjudicated by a court of law.

228. See *Lyman v. Boonin*, 635 A.2d 1029, 1032–33 (Pa. 1993) (stating that board members may not force membership at large to fund their parking spaces).

229. *DI LORENZO*, *supra* note 95, § 12:3, at 218–19.

230. See *supra* notes 39–42 and accompanying text for a discussion of the duty of care in the corporate setting.

231. Compare *COX & HAZEN*, *supra* note 28, § 4.01–4.03, at 61–66 (noting ultra vires act is null and void), with *DI LORENZO*, *supra* note 95, § 12:3, at 213–15 (noting board must act within its powers to enjoy BJR protection).

232. *DI LORENZO*, *supra* note 95, § 12:3, at 218.

233. *Louis & Anne Abrons Found., Inc. v. 29 E. 64th St. Corp.*, 746 N.Y.S.2d 482, 484 (N.Y. App. Div. 2002) (noting any departure must be justified by bona fide business purpose).

234. 736 N.Y.S.2d 9 (N.Y. App. Div. 2002).

235. *Schultz*, 736 N.Y.S.2d at 14.

236. 746 N.Y.S.2d 482 (N.Y. App. Div. 2002).

2. Courts Fail to Distinguish Between Residential and Mixed-Use Associations when Applying the BJR

All BJR jurisdictions adopted the doctrine for community association disputes in cases involving purely residential communities.²³⁷ When adjudicating claims arising out of a mixed-use community association, courts do not distinguish the very different mixed-use landscape from the purely residential context.²³⁸ In failing to make this distinction, courts improperly apply a standard of review that is not tailored for mixed-use communities, where separate and distinct classes of membership coexist.²³⁹ Although practitioners in the field recognize the propensity for problems within mixed-use communities and offer practical solutions,²⁴⁰ courts blindly apply the BJR across all community association projects without even giving a nod to the varying underlying environments.²⁴¹ Failure to acknowledge the differences is problematic because none of the rationales supporting BJR application to the residential community association apply to the mixed-use project.²⁴²

3. The Rationales That Support BJR Application in the Corporate and Residential Community Association Contexts Do Not Apply in the Mixed-Use Setting

Courts and scholars have put forth several rationales and justifications for applying the BJR in the community association setting.²⁴³ The rationales are essentially identical to those offered for the BJR's application in the corporate business setting, with perhaps the exception of one—a fear that exposure to liability will result in risk-averse behavior.²⁴⁴ Each rationalization is inapplicable to a mixed-use project, which is comprised of distinct classes possessing disparate fundamental interests.

237. See, e.g., *Tierra Ranchos Homeowners Ass'n v. Kitchukov*, 165 P.3d 173, 179–80 (Ariz. Ct. App. 2007) (residential homeowners association); *Rywalt v. Writer Corp.*, 526 P.2d 316, 317 (Colo. Ct. App. 1974) (residential homeowners community); *Papalexio v. Tower W. Condo.*, 401 A.2d 280, 285–86 (N.J. Super. Ct. Ch. Div. 1979) (residential apartment condominium); *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1321 (N.Y. 1990) (residential cooperative in New York City); *Schwarzmann v. Ass'n of Apt. Owners of Bridgehaven*, 655 P.2d 1177, 1180 (Wash. Ct. App. 1982) (residential condominium in Seattle).

238. See, e.g., *Bd. of Managers of the 229 Condo. v. J.P.S. Realty Co.*, 764 N.Y.S.2d 405, 407 (N.Y. App. Div. 2003) (relying on *Levandusky* decision as basis for BJR application to mixed-use dispute); *Louis & Anne Abrons Found.*, 746 N.Y.S.2d at 483–84 (pointing to *Levandusky* as basis for applying BJR to mixed-use dispute).

239. See *supra* notes 166–71 for a brief discussion of competing interests in mixed-use settings.

240. See *supra* Part II.D.1 for a discussion of practitioner recognition of problems within mixed-use communities.

241. See *supra* Part III.A.2 for a discussion BJR application across residential and mixed-use projects.

242. See *infra* Part III.A.3 for a more detailed argument the problems of blindly applying the BJR to mixed-use communities.

243. See *supra* Part II.B.4.d for a discussion of the rationales offered in support of BJR application in the community association context.

244. See *infra* Part III.A.3.a for a discussion of the risk-averse rationale and its corollary.

a. Risk-Taking Is Not an Appropriate Goal in Mixed-Use Communities

Perhaps the most compelling reason for the BJR in the corporate context is the adverse impact exposure to liability would have on the risk-taking behavior of corporate boards and management.²⁴⁵ No case law or scholarship supporting BJR application in the community association context directly invokes the risk rationale. The likely reason is because the rationale does not apply to the purely residential context, and even more so, it does not apply to the mixed-use context where more is at stake than a residential unit. The mixed-use community association is not an entrepreneurial enterprise where the board should take risks with the expectation of gaining huge profits.²⁴⁶ Rather, an association's primary function is to preserve the status quo.²⁴⁷ That is, the primary purpose of an association board is to preserve its members' properties and their reliance interests when they purchased their units.²⁴⁸ When viewed in this light, it is obvious that risk taking is not a board characteristic worth cultivating with a highly deferential standard of judicial review like the BJR.

In addition to the glaring differences in enterprise function, association members are not capable of enduring risk in the same unique way as corporate shareholders.²⁴⁹ Whereas, in corporate contexts, shareholders can diversify their investment portfolios, an association member's residential unit is typically her single largest investment.²⁵⁰ In mixed-use projects, a commercial unit owner operating her business relies on the profitability of that business for income. Such commercial unit owners, perhaps more so than residential unit owners, have absolutely no interest in encouraging the lay boards, which control the commercial unit owners, to make risky, unprepared decisions that affect their ability to earn a living.²⁵¹

Consider, for example, the LRA in Vail, Colorado.²⁵² The commercial unit owners were local business owners who operated their retail stores out of the same units for over ten years.²⁵³ Most of the LRA membership relied exclusively on their businesses in that location as their primary source of income. The LRA, a minority class subject to the decisions of a board unskilled and inexperienced in commercial retail matters, would in no way benefit from a board that is comfortable taking risks that could adversely affect their ability to earn income.

245. See *supra* notes 53–55 and accompanying text for discussion of the risk allocation rationale.

246. Natelson, *supra* note 141, at 45 (providing discussion of community associations generally).

247. *Id.* at 45–47.

248. *Id.*

249. See Gregory S. Alexander, *Dilemmas of Group Autonomy: Residential Associations and Community*, 75 CORNELL L. REV. 1, 55–60 (1989) (discussing judicial roles in overseeing residential associations).

250. Sterk, *supra* note 71, at 301.

251. See Natelson, *supra* note 141, at 74 (noting risk-averse expectations of community association membership and suggesting boards should act accordingly).

252. See *supra* notes 6–17 and accompanying text for a discussion of the LRA case.

253. *Lodge Retailers Ass'n v. Lodge Apt. Condo. Ass'n, Inc.*, Nos. 05CA1864 & 06CA0220, slip op. at 1–5 (Colo. Ct. App. Nov. 8, 2007).

On the contrary, commercial minority interests are best served through preservation-oriented and conservative activity, the sort of board behavior the BJR was originally designed to avoid.²⁵⁴

Some scholars argue a related rationale predicated on the fact that service on association boards is strictly voluntary.²⁵⁵ This rationale suggests that a standard of review that too easily permits courts to second-guess board decisions and impose liability would cause members to refrain from volunteering. If liability is too high, serving on a board might become too risky, and association members simply will not take that risk. Thus, the deference of the BJR is essential to ensuring continued board service.

After an analysis of the majority of disputes in the community association context, this argument loses most of its force. Unlike the corporate setting, in the community association setting plaintiffs do not typically seek money damages from board members as individuals; rather, injunctions seem to be the norm.²⁵⁶ The suits tend to seek a declaratory judgment holding certain rules or regulations null and void. The only harm to board members as individuals is perhaps the inconvenience of having to go to court and testify or the lost time in enacting a rule later deemed unenforceable.

Nevertheless, to the extent board members are sued individually, associations can enact indemnity provisions in their governing documents that insulate board members from personal liability.²⁵⁷ In *Kleinman v. High Point of Hartsdale I Condominium*,²⁵⁸ the court enforced a provision in the condominium's governing documents indemnifying the board of managers for any liability "for errors of judgment, negligence, or otherwise."²⁵⁹ In dismissing the claims against the board members, the court noted that board service is a "type of gratuitous quasi-public service [which] should be encouraged by exoneration from personal liability rather than be discouraged by imposition of personal and individual liability."²⁶⁰ Thus, courts acknowledge and uphold indemnity provisions adopted to insulate voluntary board members from liability.

Furthermore, this argument is too broad in scope because it does not exclude other possible formulations of judicial review such as the reasonableness standard. Indeed, a majority of jurisdictions already use a reasonableness standard and there is no indication that obtaining association members to serve on boards is a problem.²⁶¹ In fact, property owners associations are growing at

254. See *supra* Part II.A.2 for a discussion of the development of the BJR rationales in the corporate context.

255. See Gillette, *supra* note 139, at 1428 (noting association board membership is voluntary).

256. The overwhelming majority of cases reviewed by this Author involved plaintiffs seeking injunctive relief from an oppressive rule or regulation or declaratory judgment concerning same, not money damages from board members.

257. *Kleinman v. High Point of Hartsdale I Condo.*, 438 N.Y.S.2d 47, 47-48 (N.Y. Sup. Ct. 1979).

258. 438 N.Y.S.2d 47 (N.Y. Sup. Ct. 1979).

259. *Kleinman*, 438 N.Y.S.2d at 47.

260. *Id.*

261. See, e.g., *Mulligan v. Panther Valley Prop. Owners Ass'n*, 766 A.2d 1186, 1190-92 (N.J.

incredible rates in jurisdictions that impose the reasonableness standard rather than the BJR.²⁶² Thus, the argument that the BJR is necessary so as not to discourage board members from serving does not support its adoption over the reasonableness standard,²⁶³ which if properly administered, is deferential as well, just less so than the BJR.²⁶⁴

b. The Ill-Equipped Courts and Imperfect Litigation Rationales

A popular justification for the BJR is that courts are poorly situated to review what are, in essence, business decisions.²⁶⁵ Because courts often lack the expertise of the board, which often must render decisions in a fast-paced business world, courts should refrain from reviewing the substance of the particular board actions in light of fairness. However, this argument is incomplete because it does not adequately distinguish between business decisions and decisions in areas where courts traditionally do get involved.²⁶⁶ For example, in medical malpractice cases, courts have always considered themselves capable to adjudicate, even though medical decisions are typically highly technical and the product of years of study, apprenticeship, and experience.²⁶⁷ In light of this failure of distinction, many argue that the ill-equipped courts rationale, standing on its own, is insufficient to account for the BJR charge of judicial deference.²⁶⁸ Nevertheless, even if the ill-equipped courts rationale has some force in the corporate world, it is completely inapplicable in the community association setting and particularly so in the mixed-use development.

With respect to the expertise prong of the ill-equipped courts rationale, courts acknowledge that community association boards are generally volunteer-based and thus tend not to have the expertise characteristic of corporate business boards.²⁶⁹ The *Levandusky* court's suggestion that community association boards possess a unique knowledge of their buildings²⁷⁰ is nothing more than a feeble attempt to draw a parallel between two obviously distinct situations.

Nevertheless, even assuming that the *Levandusky* court's expertise argument is persuasive, it still does not account for the second prong of the ill-

Super. Ct. App. Div. 2001) (discussing state of community association law around country); Arabian, *supra* note 22, at 11–12 (discussing standards of review in jurisdictions and noting that majority adopt reasonableness).

262. See *supra* note 1 and accompanying text for a discussion of the widespread growth of community associations.

263. See *supra* Part II.C for a discussion of the two-tiered reasonableness approach.

264. See *infra* Part III.B for an argument for the adoption of the reasonableness standard over the BJR in mixed-use community associations.

265. See *supra* Parts II.A.2 & II.B.4.d for a discussion of the ill-equipped courts rationale.

266. Davis, *supra* note 48, at 580–83.

267. See *id.* (discussing inadequacy of ill-equipped courts rationale).

268. *Id.* at 580–83 (critiquing ill-equipped courts rationale as unpersuasive for failure to sufficiently account for other circumstances in which courts traditionally get involved); Fischel, *supra* note 24, at 1439–40 (suggesting ill-equipped courts rationale lacks completeness).

269. *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1322 (N.Y. 1990).

270. See *supra* notes 147–49 and accompanying text for an analysis of this aspect of *Levandusky*.

equipped rationale, which is predicated on the business world's fast pace. The nature of the business world often demands that boards and managers issue quick decisions, sometimes without the benefit of the best information.²⁷¹ The fact of the matter is that rarely are community association board decisions made in such a fast-paced environment that would render *ex post* judicial review somehow unfair.²⁷² Community associations are not subject to the whims of the stock market where boards must closely monitor the association's financial status to guard against vulnerability to a hostile takeover by some Wall Street tycoon. On the contrary, as a review of the cases in this Comment alone suggests, board decisions that generate disputes with membership concern matters of a more long term nature where time is not of the essence, such as assessment allocation, long-term security upgrades, approval of new ownership and leasehold interests, and regulations concerning daily life.²⁷³

In mixed-use communities there is even more reason to dispense with this argument. The situation with mixed-use associations is a combination of equally unsophisticated boards like the residential context, with considerably more complicated issues given the wide range of activity present. In such an environment, negligent management is highly probable and likely rampant.²⁷⁴ Where the stakes are high, courts should be available to review decisions, not to substitute their judgment for that of the board, but rather to ensure the decision does not unfairly frustrate the reliance interest of an entire class of owners.

c. The Contract Argument—Voluntariness

Proponents of the BJR often rely on the contractual relationship between the association and the association members.²⁷⁵ Such proponents argue that there is simply no need for judicial review of decisions that are purely voluntary.²⁷⁶ With respect to voluntary relationships like those of the corporation and its shareholders and the association and its membership, one scholar noted that “[c]oncerns about self-determination are less critical . . . because the choice to join—*or to leave*—gives an individual a measure of control, even if the individual has no ‘voice’ in the organization’s decision making process.”²⁷⁷

In the corporate context, this makes perfect sense—the decision not only to purchase but also to sell stock is usually a tenable option absent extenuating

271. *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982).

272. Robert G. Natelson, *Keeping Faith: Fiduciary Obligations in Property Owners Associations*, 11 VT. L. REV. 421, 446 (1986).

273. See *supra* Part II.D.2 for a discussion of disputes in the mixed-use context.

274. See Natelson, *supra* note 141, at 51 (arguing negligent management more damaging to community association unit owner than diversified corporate stockholder).

275. See *supra* Part II.B.4.d for a discussion of the contract view in community associations.

276. See *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1321–22 (N.Y. 1990) (arguing for lesser standard of review in part because “agreement to submit to the decisionmaking authority of a cooperative board is voluntary” and “there is always the freedom not to purchase the apartment”).

277. *Id.* (emphasis added).

circumstances. Armed with a diversified investment portfolio, a corporate shareholder might even be willing to sell stock at a loss to the extent he is unhappy with the board's management decisions.²⁷⁸

Applying these principles to the community association, however, is problematic. Commercial owners who operate their businesses out of their unit will typically find exit considerably more difficult than stockholders and even residential unit owners. In the case of the commercial business, the ability to exit will usually turn on economic issues that directly weigh on the owner's ability to provide financially for herself and those she cares about. Unlike the corporate shareholder with a portfolio, the commercial business owner is not likely to be sufficiently diversified to absorb potential losses. Moreover, commercial unit owners, unlike residential owners, might have additional concerns that frustrate their ability to exit a community related to the value of their business in terms of goodwill. Because goodwill value is often directly related to a particular location, a commercial unit owner may not realistically have the ability to exit an oppressive community. The decision to exit may often result in a loss of clientele who habitually return to a given location to purchase products and services.²⁷⁹ Courts acknowledge that goodwill is a significant asset to many businesses and that its maintenance is critical to continued success and stability.²⁸⁰ The ability for a commercial unit owner to exit what courts view as a purely voluntary relationship is not as easy as the contract view suggests. In these circumstances, where exit is not as simple as calling one's stock broker, or going online to Etrade.com, the notion that voluntariness warrants the judiciary to look the other way is unfounded.

The other aspect of the contract argument for BJR application in the corporate and residential setting is the "relational" nature of the contractual obligations of the board.²⁸¹ That is, because the terms of the contractual relationship and expectations of the contracting parties are defined loosely, courts would have a difficult time assessing claims, even if they tried.²⁸² However, as Professor Sterk noted, relational contract interpretation involves a judicial inquiry into the expectations of the parties at the time of initial agreement.²⁸³ The appeal to the relational nature of the contract then seems to sidestep the question of whether the parties would have bargained for the BJR

278. See Bainbridge, *supra* note 58, at 110–15 (discussing portfolio theory and investor ability to bear risk of loss); Fischel, *supra* note 24, at 1442 (noting that if shareholders wanted to avoid risk, they could have purchased government bonds).

279. See *supra* note 170 for a catalogue of authority linking commercial goodwill to a specific location.

280. See, e.g., *N. Clackamas Cmty. Hosp. v. Harris*, 664 F.2d 701, 706–07 (9th Cir. 1980) (recognizing goodwill as business asset that figures significantly in valuation of business).

281. See *supra* Part II.B.4.d and note 274 and accompanying text for a discussion of the contract view in residential community association setting.

282. See Sterk, *supra* note 71, at 310–11 (identifying competing incentives to illustrate courts' difficulty in determining validity of claims).

283. See *id.* at 310 (noting that BJR rests to some degree on courts being less capable than corporate managers of discerning shareholder interests).

to begin with. Professor Sterk argued that members would make that bargain only if they believed that the market itself, rather than the imposition of legal liability, adequately motivated boards to render decisions and impose regulations that were fair to all unit owners.²⁸⁴ To the extent that the interests of the membership at large were sufficiently aligned, perhaps parties would bargain for the BJR, but, as argued in the next section of this Comment, there is no such alignment of interests in the mixed-use community.

d. Alignment of Interests Is Not Present in Mixed-Use Projects

The alignment of interests that is a critical component of the foundation of the application of the BJR in both the corporate and residential community association contexts is not present in the mixed-use development where disparate property interests coexist under one roof. One scholar summarized the alignment-of-interests rationale in the residential context as follows: “The collective interest of the unit owners is not separable from the interests of individual unit owners who make up the association. Therefore, the usurpation of the board’s authority by the courts does not serve anyone’s interests.”²⁸⁵ An elemental understanding of a mixed-use project is all that is necessary to conclude that this rationale clearly does not apply. However, some practitioners in the field suggest that unit owners’ interests in mixed-use communities, while not perfectly aligned, may compliment one another.²⁸⁶ For example, commercial unit owners benefit from the patronage of the residential owners while residential unit owners have an interest in the commercial success because it “enhance[s] the . . . value of the overall project.”²⁸⁷ While these facts may very well be true, this minor overlapping of interests cannot possibly compensate for the fact that one group of owners is primarily interested in carrying on its commercial activity unfettered by limiting regulations, while the other is primarily concerned with achieving a habitable residential environment. Nevertheless, residential-dominated associations rely on this small overlap of interests to justify BJR imposition.²⁸⁸

For example, at trial, LACA presented testimony from the former president of the board, who argued that anything that brings benefit to the project overall, benefits all units, albeit disproportionately.²⁸⁹ Moreover, the former president noted that the association’s vacation rental program, which the board treated as a common element, did not benefit him directly because he did not choose to

284. *Id.*

285. Goldberg, *supra* note 87, at 676.

286. *See* Winston, *supra* note 2, at 38, 41–43 (addressing mutual benefits of mixed-use development on residential and retail).

287. *Id.* at 38.

288. *See* Response to Motion for Judgment Notwithstanding the Verdict, *supra* note 11, at 4–15 (arguing that decision to assess commercial minority for residential elements increased value of whole property and benefited all unit owners, residential and retail alike).

289. *Id.* at 9.

rent out his unit to resort vacationers.²⁹⁰ Nonetheless, the president understood that it benefited the building as whole and thus was acceptable.²⁹¹

The LRA, in contrast, offered expert disclosures from a professional appraiser concerning the effect of the board's decision to assess the retail units for vacation rental expenses on the fair market value of the commercial units at issue.²⁹² In his report, the expert noted that the assessments to the commercial units "diminish[ed] the net income to the propert[ies]."²⁹³ Because there was no corresponding benefit to the artificial reduction in net profit, a diminution in the fair market value of the commercial units resulted.²⁹⁴ In the case of LRA's nine commercial units, the properties experienced a total diminution in the fair market value between \$664,000 and \$863,000 as a result of the association's assessment practice.²⁹⁵

The experiences of the LRA in Colorado illustrate the diverse interests present and the potential for a rule or regulation to have inadvertent and significant adverse effects on minority ownership classes in a mixed-use development. The resultant diminution in value of the commercial units demonstrates the potential problems encountered in mixed-use associations where residential majorities dominate boards. Although the LACA president did not take part in the rental program, its existence probably increased the fair market value of his unit²⁹⁶ and decreased the market value of the commercial units.²⁹⁷

With respect to the contract argument,²⁹⁸ it would then appear that commercial unit owners as parties to a relational contract would not likely bargain for the BJR. BJR application is perhaps warranted in the corporate context, where, because interests are by and large aligned through market forces and incentive-based compensation packages,²⁹⁹ efforts to maximize firm value will affect ownership interests evenly.³⁰⁰ Moreover, in purely residential communities, interests may be sufficiently aligned so as to provide adequate representation to all, notwithstanding the idiosyncratic disputes highlighted by

290. *Id.*

291. *Id.*

292. Plaintiff's Initial Disclosures, *supra* note 12, at Exhibit B.

293. *Id.*

294. *Id.*

295. *Id.*

296. Sterk, *supra* note 71, at 322–23. Professor Sterk argued that association rules concerning rental restrictions that affect residential membership evenly should almost always be upheld because "self-interest should restrain resident owners from imposing unduly onerous restrictions." *Id.* at 323. Because rental restrictions reduce the market value, resident owners will not want to encumber their units because of the possibility that they will eventually sell. *Id.*

297. Plaintiff's Initial Disclosures, *supra* note 12, at Exhibit B.

298. See Sterk, *supra* note 71, at 310–11 (discussing whether residential unit owners in community association would bargain for BJR).

299. See *supra* notes 51, 61–65 and accompanying text for a discussion of the internal checks that motivate interests in corporate structure.

300. See *supra* notes 66–68 and accompanying text for a discussion of the weak incentive for minority shareholders to maximize the value of the firm.

Professor Sterk.³⁰¹ The diverse interests in mixed-use communities move beyond the merely idiosyncratic, emotionally charged life-style concerns that are the hallmark of residential association disputes, into the realm of economic sustainability. Fundamentally, commercial and residential interests are different. Courts in BJR jurisdictions should take note, and critically reassess the BJR's application since its underlying assumptions simply do not apply.

B. The Reasonableness Standard Is Appropriate in the Mixed-Use Context

Courts in reasonableness jurisdictions acknowledge the special case of the mixed-use community,³⁰² and courts in BJR jurisdictions should do the same. In its decision to adopt a reasonableness standard in Maryland, the *Ridgely I* court took specific note of the need for a less discretionary standard of review in the context of mixed-use communities.³⁰³ The court cautioned against applying a "restrained, deferential standard to use restrictions" where a distinct minority is present, like commercial unit owners, whose interests could be disproportionately affected by discriminatory regulations.³⁰⁴ In *Ridgely I*, the condominium consisted of 232 units where only seven units on the ground floor were designated as commercial.³⁰⁵ The court acknowledged that "[t]he basic nature of this set up *naturally* creates competing interests between the residential and commercial owners."³⁰⁶ Because of the competing interests and the limited voice and ability of the commercial unit owners to effect change, the court determined that a restrained and deferential standard was inappropriate.³⁰⁷

Applying a BJR review to the facts of *Ridgely* illustrates the BJR's inadequacy in the mixed-use context. If the *Ridgely* board enacted the lobby-use restriction in New York, Colorado, or some other BJR jurisdiction, the restriction would receive BJR protection and the commercial unit owners would be forced to either exit or conduct their businesses as second-class citizens within their community.

301. See *supra* notes 85–86 and accompanying text for a discussion of idiosyncratic interests in residential communities. See Alan Price Young, *Consistent Conflicts*, in *NEW ISSUES IN CONDOMINIUM AND HOMEOWNER ASSOCIATIONS: CONFLICTS AND THE COURTS* 39, 41 (Pa. Bar Inst. 2007) (suggesting personalities and intense emotion typically drive litigation in residential community association disputes).

302. See, e.g., *Ridgely Condo. Ass'n, Inc. v. Smyrnioudis (Ridgely I)*, 660 A.2d 942, 950 (Md. Ct. Spec. App. 1995) (noting unique characteristics of mixed-use community).

303. *Id.*

304. *Id.*

305. *Id.*

306. *Id.* (emphasis added).

307. *Ridgely I*, 660 A.2d at 950 (noting that voting structures in place permitted residential domination over commercial interests). *But see* *Bd. of Managers of the 229 Condo. v. J.P.S. Realty Co.*, 764 N.Y.S.2d 405, 408 (N.Y. App. Div. 2003) (dismissing out of hand plaintiff's contention that BJR should not apply in light of inherent conflict of interest in mixed-use context).

1. The *Ridgely* Board Acted Within Its Powers

Faced with the task of rebutting the BJR presumption, the plaintiffs in *Ridgely* would be unable to prove that the board acted outside the scope of its power. The regulation restricting commercial customers from using the lobby for egress and ingress was the product of an association-wide vote that met threshold statutory and internal standards.³⁰⁸ Indeed, the *Ridgely* plaintiffs stipulated that the procedures used to adopt the rule were proper and that the general responsibility of maintaining and ensuring the security of unit members was clearly within the board's discretion.³⁰⁹ Therefore, the regulation would meet the first prong of BJR protection.

To the extent that a plaintiff pled that the board breached a provision of the association's governing documents by enacting the rule, a court might still allow BJR protection in some BJR jurisdictions. For example, in *Colorado Homes, Ltd. v. Loerch-Wilson*,³¹⁰ the court permitted a BJR defense to the plaintiffs' breach of contract claim against the board.³¹¹ Although the court focused on the board's discretion with respect to the manner and timing of enforcement, it nonetheless allowed a BJR defense to a claim of breach of contract—an act beyond the power of any board.³¹²

2. The *Ridgely* Board Acted in Good Faith

Similarly, the plaintiffs would be unable to establish that the board acted in bad faith to avoid BJR protection. To avoid BJR protection, the plaintiffs must show that a board or association action bears no rational relation to the welfare of the community.³¹³ In New York, one example of this is the presence of a personal vendetta on the part of the board against a unit member who claims discrimination to establish bad faith. With this standard, the association's by-law restricting commercial customers' lobby use would certainly not rise to the level of bad faith necessary for the plaintiffs to avoid BJR protection. Even the Maryland court applying the reasonableness standard acknowledged the legitimate security concerns that gave rise to the regulation.³¹⁴ The difference between the two approaches, however, is that in BJR jurisdictions the inquiry

308. *Ridgely Condo. Ass'n, Inc. v. Smyrnioudis (Ridgely II)*, 681 A.2d 494, 497 (Md. 1996) (noting that by-law amendment need only receive two-thirds of membership vote).

309. *Id.*

310. 43 P.3d 718 (Colo. Ct. App. 2001).

311. *Colo. Homes, Ltd.*, 43 P.3d at 723–24.

312. *Id.* In an unpublished opinion, the Colorado Court of Appeals recently held that the BJR is not available as a defense to a properly pled claim of breach of contract. *Lodge Retailers Ass'n v. Lodge Apt. Condo. Ass'n, Inc.*, Nos. 05CA1864 & 06CA0220, slip op. at 25–28 (Colo. Ct. App. Nov. 8, 2007). The court distinguished *Colorado Homes*, which the court viewed as an exception to the general rule denying BJR protection to breach of contract claims. *Id.* at 28. The Colorado Supreme Court denied certiorari. *Lodge Apt. Condo. Ass'n, Inc. v. Lodge Retailers Ass'n*, No. 07SC1092, 2008 WL 2486399, at *1 (Colo. June 23, 2008).

313. See *supra* Part II.B.4.b for a discussion of the requirement of good faith in BJR analysis.

314. *Ridgely Condo. Ass'n, Inc. v. Smyrnioudis (Ridgely II)*, 681 A.2d 494, 497 (Md. 1996).

would cease once the court found that the decision bore a relation to the interests of the community, while a reasonableness court would probe further, taking into consideration the discriminatory effect of the regulation itself.

The Maryland Special Court of Appeals, applying a reasonableness standard, looked to the totality of the circumstances.³¹⁵ The court weighed the commercial interests at play and held that that the board must first exhaust other, less intrusive solutions to the security problem before implementing a policy that frustrates the reasonable reliance interests of the commercial unit owners.³¹⁶ In considering the reliance interest of the commercial unit owners, the court noted their substantial commercial investments.³¹⁷ One commercial unit owner made a \$40,000 investment to remodel his office with a greeting area oriented around the lobby entrance.³¹⁸

Compare this reasonableness standard to the *Levandusky* court's BJR approach. Although a professional engineer acknowledged that there was no danger of harm after the plaintiff's remodeling and repositioning of the steam pipe, the court nonetheless ordered the plaintiff to reverse the work.³¹⁹ The court ignored the plaintiff's substantial investment, and, moreover, ignored the plaintiff's claim of a personal vendetta against him in light of the board's uneven enforcement of the rule.³²⁰ Like in *Levandusky*, a court in a BJR jurisdiction would be unable to make the finding of bad faith necessary for it to reach the substance of the claim on account of the legitimate security concerns that gave rise to the lobby-use restriction.

3. The *Ridgely* Board Satisfied Its Duty of Care

The *Ridgely* plaintiffs would be unable to avoid BJR protection by claiming the board breached its duty of care. To obtain BJR protection, a board must reasonably inform itself under the circumstances.³²¹ This requirement, like the duty to act in good faith, poses little difficulty for boards to satisfy because courts interpret the standard to require gross, or in some cases, even criminal, negligence.³²² The *Ridgely* board satisfied its duty of care under BJR standards because it was acting on the safety concerns of association members.³²³ Moreover, at trial the county Crime Prevention Coordinator testified that the condominium was relatively safe, but suggested that security could be improved if the commercial customers used only the exterior store entrances.³²⁴ Ordinary

315. *Id.* at 496–501.

316. *Id.*

317. *Id.* at 496–97.

318. *Id.* at 496.

319. *Levandusky v. One Fifth Ave. Apt. Corp.*, 553 N.E.2d 1317, 1323–24 (N.Y. 1990).

320. *Id.* at 1323.

321. *DI LORENZO*, *supra* note 95, § 12:3, at 219.

322. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

323. *Ridgely Condo. Ass'n, Inc. v. Smyrnioudis (Ridgely II)*, 681 A.2d 494, 497 (Md. 1996).

324. *Id.* at 497 n.6.

negligence, much less gross negligence, could not be established because the board was responding to some members' security concerns and a law enforcement expert endorsed the board's actions.

4. The *Ridgely* Board Observed Its Duty of Loyalty Because Self-Dealing Cannot Be Established

The self-dealing standard would likely prevent the *Ridgely* plaintiffs from establishing that the board breached its duty of loyalty by enacting the lobby-use restriction. To establish self-dealing, a plaintiff must show that the board gained a benefit "at the expense of imposing an impermissible burden."³²⁵ The plaintiffs would have a difficult time convincing a court that they too did not receive a benefit by the increased security as a result of the use restriction. In *Lyman v. Boonin*³²⁶ the court only entertained the claim of self-dealing because the nonresident minority alleged that it had received no benefit from the board-implemented parking scheme.³²⁷ As a matter of practicality, the retail units could never obtain a parking space.³²⁸ In the case of *Ridgely*, even though the benefit is disproportionate, the increased security would certainly benefit all owners and thus any claims of self-dealing necessary to establish a breach of the duty of loyalty would be unlikely to sway a BJR court that approaches the dispute with a presumption that the board acted properly.

5. The Duty to Treat All Units Fairly and Evenly Will Not Save the Day

Despite its pro-minority veneer, New York's pronounced duty to treat all unit owners fairly and evenly is not likely to prevent BJR protection. In the cases where the duty was applied, the courts subordinated its role to the duty to act in good faith, thus negating much of its potential force.³²⁹ In the case of *Ridgely*, there is clearly a justifiable and bona fide purpose in enacting the rule, namely, to address the security problem.³³⁰ The *Schultz* court further suggested that the duty to treat unit owners fairly and evenly does not extend over classes of membership, but rather requires that boards treat all members within a particular class evenly.³³¹ The court's articulation seems to permit discriminatory rule-making so long as the rule treats all members of a particular class the same and bears a rational relation to the welfare of the association. The duty to treat all unit owners fairly and evenly would not save the *Ridgely* plaintiffs because

325. *Lyman v. Boonin*, 635 A.2d 1029, 1032 n.7 (Pa. 1993).

326. 635 A.2d 1029 (Pa. 1993).

327. *Lyman*, 635 A.2d at 1030. See *supra* notes 129–31 and accompanying text for a discussion of self-dealing in the community association context.

328. See *Lyman*, 635 A.2d at 1030 (noting that severe parking shortage ensured that retail tenants would never obtain parking space).

329. See *Louis & Anne Abrons Found., Inc. v. 29 E. 64th St. Corp.*, 746 N.Y.S.2d 482, 484 (N.Y. App. Div. 2002) (noting departure from uniform treatment of unit owners must serve bona fide business purpose).

330. *Id.*

331. *Schultz v. 400 Cooperative Corp.*, 736 N.Y.S.2d 9, 14 (N.Y. App. Div. 2002).

the lobby-use restriction applied to all commercial unit owners and, as mentioned earlier, it clearly related to the association's legitimate security concerns. Thus, notwithstanding the various procedural safeguards of the BJR, the lobby-use restriction that so clearly deprived an entire minority class of commercial unit owners of their reliance interests would pass judicial muster under the BJR.

IV. CONCLUSION

The law governing community association disputes is split, with a majority of states adopting a reasonableness standard and a minority of states implementing the BJR standard of review.³³² Jurisdictions adopting the BJR developed their community association law largely in the context of the purely residential project.³³³ In the residential setting, where all association members own comparable properties, are likely situated in a similar economic fashion, and share a considerable number of interests relating to the community, arguments supporting application of the highly deferential BJR have some force.³³⁴ However, the emergence of the more complex mixed-use project calls into question many of the assumptions on which BJR application rests.³³⁵

In the mixed-use setting, condominiums, cooperatives, and other community association structures are no longer comprised solely of members with the naturally aligned interests that convinced the courts to adopt the BJR as a standard of review for resolving disputes. Rather, within mixed-use projects, clearly identifiable minority groups exist: typically the ground-floor commercial unit owners, whose ability to earn a living is often dependent on association board decisions. Because of the power structure provided for in the governing documents, such boards consist predominantly of residential members who share very little in common with their commercial neighbors.

The BJR's process-based approach to reviewing disputes more often than not results in blanket protection for board decisions without consideration of the substance of the rule or regulation itself.³³⁶ The rigors of overcoming the BJR presumption that board decisions are valid leave the reliance interests of the minority class subject to the beneficence of the residential-dominated board. In a mixed-use community where "[t]he basic nature . . . naturally creates competing

332. See, e.g., *Mulligan v. Panther Valley Prop. Owners Ass'n*, 766 A.2d 1186, 1190–91 (N.J. Super. Ct. App. Div. 2001) (discussing state of community association law around country); *Arabian*, *supra* note 22, at 11–18 (discussing standards of review in jurisdictions and noting majority adopt reasonableness).

333. See *supra* notes 237–48 and accompanying text for a discussion of the adoption of the BJR in a residential context.

334. See *supra* notes 150–52 and accompanying text for a discussion of the internal alignment of interests in a purely residential context.

335. See *supra* Part III.A.3 for an argument that none of the BJR rationalizations apply in the mixed-use context.

336. See *supra* Part III.B for an illustration of the failure of the BJR's process-based approach to reach the substance of claims.

interests between the residential and commercial owners,”³³⁷ courts should critically reevaluate their earlier decisions to apply the BJR and fashion a separate standard of review.

The reasonableness standard is better suited than the BJR to balance the competing interests inherent in a mixed-use community and to ensure the reliance interests of all unit owners. Because of the reasonableness standard’s two-tiered approach,³³⁸ courts are properly restrained from second-guessing decisions made when the complaining unit owners had full notice to the disputed rule, regulation, or other board action, but at the same time, courts have the flexibility to reach the substance of rules and regulations that may unfairly deprive unit owners of their reasonable reliance interests in their investments.

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337. *Ridgely Condo. Ass’n, Inc. v. Smyrnioudis (Ridgely I)*, 660 A.2d 942, 950 (Md. Ct. Spec. App. 1995).

338. See *supra* Part II.C for a discussion of the reasonableness standard.

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