

Derivative Claims within HOAs: An Overlap of Property and Business Law

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I. Why Derivative Claims are Relevant to Property Law

- a. HOAs are generally non-profit corporations.
- b. Derivative claims pop up in HOA cases and can be difficult to identify and separate from title claims. If not properly notice and plead, those claims could be forfeited.

II. Defining a Derivative Claim

- a. Claims brought either by the company itself against the directors, or by the shareholders against the company, to enforce a corporate right or duty.
- b. "A stockholder's derivative action is an action brought by one or more stockholders of a corporation to enforce a corporate right or remedy a wrong to the corporation in cases where the corporation, because it is controlled by the wrongdoers or for other reasons fails and refuses to take appropriate action for its own protection." *McCann v. McCann*, 138 Idaho 228, 233, 61P.3d 585, 590 (2002).
- c. Common Derivative Claims in HOAs : Breach of fiduciary duties; Wrongful use of dues

III. Identifying Derivative Claims

- a. Classic title claims in an HOA
 - i. From a member: Does this apply to my property?
 - ii. From the HOA: Lien foreclosures; enforcement actions
- b. Derivative claims brought on behalf of the HOA
 - i. HOA can sue a director for a failure to fulfil their corporate duties.
 - ii. Board discovers that director has misapplied funds that belong to the company.
Derivative.
- c. Derivative claims brought on by a member
 - i. "An action brought by a shareholder is derivative if the gravamen of the complaint is the injury to the corporation or to the whole body of its stock or property and not injury to the plaintiff's individual interest as a stockholder." *McCann v. McCann*, 138 Idaho 228, 233, 61P.3d 585, 590 (2002).
 - ii. Not able to vote at a meeting because the board did not give any members notice of the meeting. This impacts all members the same.
 - iii. Board implemented dues that were not within their authority to charge.
Impacts all members.
 - iv. Claim depends on relief sought. Change in title impact or asking for specific performance to vote?
- d. Personal, non-derivative, claims – direct claims
 - i. Not able to vote at a meeting, because member was singled out and not given notice. Member was charged different dues than other members. Only impacts one member.
 - ii. "They generally do not include suits alleging violation of duties by corporate officers, such as negligence, mismanagement, self-dealing, excessive compensation or squeeze outs." *McCann v. McCann*, 138 Idaho 228, 233, 61 P.3d 585, 590 (2002)

IV. Pleading Derivative Claims

- a. Notice and Corporation & Non-Profit Acts

- i. Title 30, Chapter 29 is the Corporation Act, Title 30, Chapter 30 is the Non-Profit Corporation Act.
 1. There is no binding case law on which to apply. I start with the Non-Profit Act, but in places where the Non-Profit Act is silent, I turn to the Corporations Act.
- ii. I.C. § 30-29-742
 1. No shareholder may commence a derivative proceeding until:
 - (a) A written demand has been made upon the corporation to take suitable action; and
 - (b) Ninety (90) days have expired from the date delivery of the demand was made unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result by waiting for the expiration of the ninety (90) day period.
 2. "The function of the demand doctrine... is a matter of substance, not procedure." *Kugler v. Nelson*, 160 Idaho 408, 415 (2016).
 3. "the stockholder must make an earnest and sincere, and not a feigned or simulated, effort to induce the directors to take remedial action in the corporate name. Statements should be presented to the directors showing the wrong complained of, accompanied by sufficient responsible data which will enable the directors to determine whether litigation could be engaged in with some hope of success. The shareholder must state facts, not mere general charges and conclusions. The demand should give the directors a fair opportunity to initiate the action which the shareholder wants to undertake, and name the potential defendants, as well as the shareholder making the demand." McCann
- iii. § 30-30-411 Derivative suits.
 - (1) A proceeding may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor by:
 - (a) Any member or members having five percent (5%) or more of the voting power or by fifty (50) members, whichever is less; or
 - (b) Any director.
 - (2) In any such proceeding, each complainant shall be a member or director at the time of bringing the proceeding.
 - (3) A complaint in a proceeding brought in the right of a corporation must be verified and alleged with particularity the demand made, if any, to obtain action by the directors and either why the complainants could not obtain the action or why they did not make the demand. If a demand for action was made and the corporation's investigation of the demand is in progress when the proceeding is filed, the court may stay the suit until the investigation is completed.

iv. Fee provisions

b. Notice and Civil Rules

i. Idaho Rule of Civil Procedure 78

(a) Prerequisites. This rule applies when one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association.

(b) Pleading requirements. The complaint must be verified and must:

(1) allege that the plaintiff was a shareholder or member at the time of the transaction complained of, or that the plaintiff's share or membership later devolved on it by operation of law;

(2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack; and

(3) state with particularity:

(A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and

(B) the reasons for not obtaining the action or not making the effort.