

ASSOCIATION LIABILITY FOR BOARD ACTIONS

The Basics about Fiduciary Duty

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I. **Community Association Basics.** It is essential to have a basic understanding of the characteristics of the community associations in order to appreciate the legal complexities of risks and liabilities created for the association through the actions and inactions of the governing body - the Board of Directors.

A. **Mandatory Membership**

1. Upon acceptance of the deed to property subject to a community association, each owner becomes a member. Membership is not optional - in contrast to membership in a civic association, which is voluntary.
2. The individual owner and resident or occupant thereby submits to the authority of the Community association and the restrictions established in the governing documents.

B. **Control**

The community association has authority to control the use and enjoyment of private property. No other entity other than local, state or national government has the power to regulate private property in such a manner.

C. **Two Roles of a Community Association**

The Community association performs two roles - that of a government and that of a business.

1. **Government Role**
 - a. The role of the Community association as a Government arises from:
 - i. Power to control property.
 - ii. Power to levy, or tax through assessment authority.
 - b. Basis for Authority

- i. State law ordains the creation of the Association.
- ii. The governing documents establish:
 - (a) Authority to finance services provided by the Community association through assessments - the power to tax.
 - (b) Use restrictions - the power to adopt laws.
 - (1) Sale or lease of unit
 - (2) Parking
 - (c) Penalties for violations - the power to enforce.
 - (1) Monetary
 - (2) Restrictions on use of facilities

The powers of the community association have constitutional implications - the association's actions are "public" in a constitutional law sense. Therefore, there must be the minimal observance of due process and equal protection.

- c. Services Performed - The Community association provides its services to members, which may include:
 - i. Utility services
 - ii. Common area maintenance such as road maintenance, exterior structure maintenance, landscaping, snow removal
 - iii. Street lighting
 - iv. Refuse removal
 - v. Security services
 - vi. Communications

2. Business Role

- a. The Community association provides services for and to its members.
- b. Legal and business duties result from provisions of the governing documents.
- c. The governing documents make officers and directors responsible for a variety of business matters, which may include:
 - i. Finances
 - ii. Asset and property management

- iii. Taxation
- iv. Insurance
- v. Employee relations
- vi. Warranty issues

II. Duty of the Directors and Officers

- A. Directors and Officers are responsible for making policy and for the overall supervision of the affairs of the community association.

They must discharge this duty in good faith and with degree of care, diligence and skill, which an ordinarily prudent person would exercise under similar circumstances.

- B. Directors, even though they are volunteers, owe a duty of care called an "undivided loyalty and honesty" or "fiduciary duty" to the Community association and to the members, the people who elected them.

- C. Business Judgment Rule - The Business Judgment Rule applies in determining whether an officer or director has acted properly.

1. Elements of the Business Judgment Rule

- a. An officer or director is not liable for his or her actions if such officer or director exercises the degree of care and skill as an ordinarily prudent director in a similar business.
- b. Normally the court will not review the business judgment of an officer or director if it is based upon authority found in the documents.
- c. The presumption is that an officer or director acts without corrupt motives and in good faith.
- d. The burden to show bad faith is placed on the individual who challenges the conduct of an officer or director.

2. Protections
 - a. Know the business of the Community association.
 - b. Attend and participate in meetings - if absent - have the meeting minutes reflect the reason for the absence.
 - c. Register dissent.
 - d. Know the governing documents.
3. Decision-Making
 - a. An officer or director must act in "good faith."
 - b. Ordinary prudent person under similar circumstances
 - c. An officer or director must avoid enhancing his or her personal interest - self-dealing must be avoided. An officer or director must act in the best interest of the Community association.
 - d. An officer or director's free and honest exercise of judgment not influenced by personal or other consideration except for welfare of the community.

III. Categories of Potential Liability

A. Three Primary Classifications

1. Governmental responsibilities
2. Business
3. Tort actions

B. Governmental Responsibilities ("Mini-Government")

1. Majority deal with enforcing rules or exterior alterations; pets; parking; TV antennae
2. Due process/civil rights/discriminations
3. Right of first refusal
4. Assessments/fiscal responsibilities
5. Amendments to government documents
6. Voting

Discrimination based upon race, sex, religion, creed, national origin is illegal - directors - even with advice of counsel are personally liable.

Normally the courts will look to see if Board Actions were REASONABLE - in rule enforcement.

C. Business

1. Greatest area of concern is mismanagement. over delegation; lack of supervision.
2. Conflict of interest - must fully disclose.

D. Tort Actions

1. General

- a. Community association can sue and be sued.
- b. Those injured have standing to sue the Community association.

2. Typical Areas of Tort Liability

- a. Employee/labor issues
- b. Swimming pools - recreational facilities and activities
- c. Security issues - inadequate lighting
- d. Defective common elements; road, slip and balconies
- e. Parties - liquor - food
- f. Association vehicles - trucks, mowers, etc.
- g. Environmental issues:
 - i. Asbestos
 - ii. Radon
 - iii. Chlordane
 - iv. Leaking Underground Storage Tanks ("LUSTs")

IV. Methods of Protection

- A. Awareness and understanding of the potential liabilities.
- B. Incorporation of the condominium unit owners association in non-Uniform Condominium Act states.
- C. Good Governing Documents
 1. Establish proper procedures:
 - a. Built-in safeguards
 - b. Notice
 - c. Hearing (opportunity to be heard)

- d. Appeal
- e. Timeliness requirements with due process - equal protection and good business practice

For example the ability to impose a monetary charge for rule violations - Build America case.

- a. Clear, concise rules
- b. Applied uniformity
- c. Reasonable

- 2. Indemnification Provisions - Caveat: If such provisions are too broad they may be against public policy.

D. Directors and Officers Liability Insurance. The Community association should carry coverage, which expressly covers breaches of fiduciary duty.

- 1. Recommended provisions

- a. "Occurrence policy" vs. "claims made" policy
- b. Prior directors
- c. Deductibles/limits sharing of loss payment
- d. Attorneys' fees and court costs (Note: 70 percent of payouts have been for costs of defending suits - not judgments)

- 2. Usual Exemptions. Generally there is no coverage available for:

- a. Illegal acts
- b. Discrimination
- c. Failure to insure ("volunteer" should be covered by worker's compensation insurance)
- d. Libel and slander
- e. Defamation of character

- 3. Other considerations

- a. "Custom" policy vs. "Package Deal" - less area covered, less cost
- b. "Segregation of the guilty party" provisions
- c. Coverage for committee members

V. Miscellaneous

A. Executive Session of Board

1. Consultation with legal counsel
2. Personnel matters
3. Contracts in negotiation
4. Report only Decisions Not Discussions

B. Fidelity Bonds

1. Frequently only the manager's employees are covered, not the owner - and then only stealing management company money as opposed to Association funds.

C. Self Help

1. Proceed with caution.
2. Great exposure.