

ACTHA FALL 2011 CONFERENCE
“Fiduciary Duty – Owner vs. Association”
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Legal/Strategic/Practical Considerations
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I. Legal bases

- A. Fiduciary duty: A duty of utmost good faith, trust, confidence and candor owed by a fiduciary (a fiduciary is a person who is required to act for the benefit of another person in managing another’s money or property and on all matters within the scope of their relationship; for example, a corporate officer is a fiduciary to the corporation); a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person. Black’s Law Dictionary (9th Edition).
- B. Business judgment rule: “The presumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation’s best interest. The rule shields directors and officers from liability for unprofitable or harmful corporate transactions if the transactions are made in good faith, with due care, and within the directors’ or officers’ authority.” Black’s Law Dictionary (9th Edition)
- C. Key considerations:
1. Duty of care – Duty to act with reasonable prudence.
 2. Duty of loyalty – Avoid conflict of interest.
 3. Duty owed to the owners as a group/corporation, not as to each individual member
 4. Exculpation and indemnification
 - a. Exculpation: relieving a party of liability resulting from a negligent or wrongful act.
 - b. Indemnity: making good a loss, damage or liability incurred by another
 - (1) By contract/agreement/declaration and bylaws

(2) By statute (for example, Illinois General Not for Profit Corporation Act, Section 108.75)

c. Exceptions: Bad faith, fraud, outside scope of authority, and willful misconduct

II. Strategic Considerations

A. Officer and director education: Not just want to be on the board but also want to know how to conduct the association's operations.

B. Unit owner education: What is the proper rule and alternatives of the unit owners; avoid unnecessary conflict by fostering understanding (and possibly agreement); both generally and in a given instance (e.g. unit owners' rights and role in board meeting; adoption of budget/assessments; and deciding aesthetic aspects of the property).

C. Obtain the proper types and amounts of insurance

1. Directors and officers liability coverage

2. Employment Practices

3. Discrimination charges

4. Non-monetary relief lawsuits (e.g. declaratory judgment or injunction actions)

D. Alternative dispute resolution and intervention

1. Mediation – mandatory and cooperative

2. Arbitration – mandatory and adversarial

III. Practical Considerations

A. Even paranoid people have real enemies

1. The "usual suspects" – chronic problem people

2. The "enemy within" – unexpected adversary (arising from a past slight or current misgiving)

3. Possible sources of attack

a. Unit owners

- b. Fellow directors and officers (past and present): especially dangerous and difficult to handle
- c. “fiduciary” duty created by specific circumstances (e.g. individual owner; employee)
- d. Role reversal – Association sues management company (principal v. agent) for misconduct resulting in a claim against association; check the management contract provisions

B. Submitting insurance claims

- 1. Timeliness is critical
- 2. To multiple carriers for possible alternative coverages (e.g. fiduciary duty breach and also property damage; also multiple years if different carriers)
- 3. Notification for informational purposes vs. actual claim (but it may still affect your premium/cancellation)
- 4. Deductibles – how to handle; for condominium associations, see Section 12(c) of Illinois Condominium Property Act (“ICPA”)
- 5. Insurance defense of a claim
 - a. Expertise v. economics
 - b. Loss of control

C. Possibly have to fight with your insurance carrier as to coverage and defense of claim (declaratory judgment action is lawsuit seeking a judicial determination of the parties’ respective rights and obligations, if any).

IV. Case Studies

A. A unit owner’s spouse consistently creates a disturbance in the early morning hours, awaking adjacent residents in a multi-floor, multi-unit condominium building. The spouse refuses to make any adjustments or take any medication (which would alleviate the problem). The Board sues to evict the spouse, who then countersues the Board for disability discrimination. The insurance carrier for the Association files a declaratory judgment action stating that it has no defense or coverage obligation to the Association.

Points to consider: Discrimination coverage is critical in current times; claimants may not be “reasonable”; good lawyering is essential.

- B. A couple purchases a condominium unit, and the husband is elected to the board of directors. Within a year after that closing, the board considers adoption of a special assessment to retire a multi-million dollar loan previously taken out for capital repairs and to fund the reserve account. The couple sues the management company and the association for violating ICPA Section 22.1 (resale disclosure), alleging that they were misled about the “true status” of the reserve fund, and claiming that they overpaid for their unit.

Points to consider: Watch those ICPA Section 22.1 disclosures and establish a consistent and undeviating ritual in issuance.

- C. The unit owners are unhappy about their condominium declaration, which required membership in a sports club owned by the developer. The board allowed a volunteer group of unit owners to prepare and record an amendment to the declaration whereby that mandatory membership was supposedly eliminated. A unit owner buys a unit and relies upon that recorded amendment. The developer/sports club sues that unit owner claiming that the amendment was not validly done. The unit owner sues the board of directors to indemnify her if she loses the case brought by the developer and to reimburse her for \$50,000 in accumulated attorney’s fees. The D&O carrier rejects the board’s claim and files a declaratory judgment action and wins. The association’s insurance broker is sued for obtaining the “wrong type” of D&O policy and the broker’s E&O carrier ends up funding the settlement of the case.

Points to consider: Never let unit owners do the board’s job; get expert legal assistance in doing amendments; know exactly what insurance you have.

- V. Murphy’s Law: “If something can go wrong, it will.”

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