

HUSCH BLACKWELL



Fiduciary Duties of Board of Directors and Officers in a Condominium Association or HOA

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I. Law

A. A corporate director is subject to a fiduciary duty of:

1. Individual loyalty
2. Good faith; and
3. Fair dealing in conducting corporate business;

Racine v. Weisflog, 165 Wis.2d 184, 190, 477 N.W.2d 326, 329 (Ct. App. 1991), and favorably cited in the unpublished case of *Walter v. Lauderdale Shores Condominium Ass'n.*, 169 Wis.2d 466, 1992 WL 191217 (Wis. App.)

4. Care; and

5. Obedience to carry out the purposes of the corporation as they are stated in the organizations articles, bylaws and/or declaration. (Always subject to Wisconsin case law that provides that “a restriction on the use of real estate must reasonable under all of the facts and circumstances.” *Le Febvre v. Ostendorf*, 87 Wis.2d 525, 275 N.W.2d 154, 159 (1979))

A Guide for Wisconsin Nonprofit Organizations, Ch. 4, Pg. 9, State Bar of Wisconsin (2011)

- B. **Fair Dealing.** Officers and directors of nonstock corporations can be held liable for “a willful failure to deal fairly with the corporation or its members in connections with a matter in which the director or officer has a material conflict of interest.” (Sec. 181.0855(1)(a)).
- C. **Good Faith & Loyalty.** Once a fiduciary relationship exists in a corporate setting, a fiduciary has a duty “to act with utmost good faith and loyalty in managing the corporation” and is prohibited from enhancing his or her “own personal interests at the expense of corporate interests.” *Melish v. Vogel*, 35 Ill.App.3d 125, 136, 343 N.E.2d 17 (1975).
- D. **Care.** Officers and directors of nonstock corporations are personally liable for their “willful misconduct.” (Sec. 181.0855(1)(d) Wis. Stat. The Wisconsin Court of Appeals has found that one way to prove willful misconduct is to show that a director’s or officer’s “predominant motive” was to prevent a creditor from collecting on a debt. *IGL-Wisconsin Awning, Tent & Trailer Co., V. Milwaukee Air & Water Show, Inc.*, 185 Wis.2d 864, 876, 520 N.W.2d 279 (Ct. App. 1994).
- E. **Loyalty.** In an oft cited case around the country it was held that a board owes a duty of loyalty to the association and must act for the benefit of the residents collectively. *Levandusky v. One Fifth Ave., Apartment Corp.*, 75 N.Y.2d 530,538, 553 N.E.2d 1317, 1321-22, 554 N.Y.S.2d 807, 811-12, 58 USLW 2613.
- F. This Fiduciary Duty can be breached in a number of ways:
1. Usurping a corporate opportunity (*Walter v. Lauderdale Shores Condominium Ass'n.*, 169 Wis.2d 466, 1992 WL 191217 (Wis. App.) condominium officer and director purchased adjacent real estate while condominium was considering and investigating purchasing the property)
 2. Failing to establish an adequate reserve budget. (*Raven's Cove Townhomes, Inc. v. Knuppe Development Company* (1981) 114 Cal. App. 3d 783.
 3. Failing to ascertain the condition of the common areas. (*Board of Managers of Fairways at North Hills Condominium v. Fairway at North Hills*, 193 A.D.2d 322, 603 N.Y.S.2d 867 (1993) and *Behm v. Victory Lane Unit Owners' Assn., Inc.* 133 Ohio App.3d 484, 728 N.E.2d 1093 (1999));

4. Failing to correct deficient construction of units. (*Board of Managers of Fairways at North Hills Condominium v. Fairway at North Hills*, 193 A.D.2d 322, 603 N.Y.S.2d 867 (1993) and *Behm v. Victory Lane Unit Owners' Assn., Inc.* 133 Ohio App.3d 484, 728 N.E.2d 1093 (1999)).
5. Failing to determine cash requirements for the purpose of calculating accurate maintenance expenses. (*Board of Managers of Fairways at North Hills Condominium v. Fairway at North Hills*, 193 A.D.2d 322, 603 N.Y.S.2d 867 (1993) and *Behm v. Victory Lane Unit Owners' Assn., Inc.* 133 Ohio App.3d 484, 728 N.E.2d 1093 (1999)).
6. Failing to establish an adequate contingency reserve to offset unforeseen expenses. (*Board of Managers of Fairways at North Hills Condominium v. Fairway at North Hills*, 193 A.D.2d 322, 603 N.Y.S.2d 867 (1993) and *Behm v. Victory Lane Unit Owners' Assn., Inc.* 133 Ohio App.3d 484, 728 N.E.2d 1093 (1999)).
7. Failing to have open, fair and unbiased elections. *O'Leary v. Board of Directors, Howard Young Medical Center, Inc.*, 89 Wis.2d 156, 2789 N.W.2d 217 (1979)
8. Engaging in self-dealing – “a willful failure to deal fairly with the corporation or its members in connection with a matter in which [they have] a material conflict of interest;” (Sec. 181.0855(1)(a) Wis. Stat., *Board of Managers of Fairways at North Hills Condominium v. Fairway at North Hills*, 193 A.D.2d 322, 603 N.Y.S.2d 867 (1993) and *Behm v. Victory Lane Unit Owners' Assn., Inc.* 133 Ohio App.3d 484, 728 N.E.2d 1093 (1999)).
9. Failing to disclose to the members or shareholders all of the material facts which they knew prior to seeking a member or shareholder vote on a subject. *Smith v. Van Gorkom*, 488 A.2d 858 (Del., 1985).

II. Summary of the Law

“Through the very nature of the officers or directors relations to the association, which are created by law and provide not only an opportunity but, indeed, an obligation in most cases to exercise a controlling influence over the rights, interests, and property of others, he or she is in a position of trust and confidence in respect to the other association members. As a consequence the individuals who serve as volunteer officers and directors are held to a high standard of conduct, the breach of which may well subject each of them or all of them to individual liability, notwithstanding the fact that each acts on behalf of the association. This high standard of conduct is, of course, the duty of the fiduciary.” Hyatt, *Condominium and Homeowner Association Practice: Community Association Law* (A.L.I. 1981) [at 59].

III. Reasonable Standard

- A. In Good faith – Section 181.0850 Wis. Stat. A Director can rely on:
 - 1. An officer or employee if believe in good faith that the person is reliable and competent.
 - 2. The advice of an attorney, accountant or other expert; or
 - 3. A committee, if they are not a member of the committee and believe in good faith that committee merits confidence.
- B. Exercising Ordinary Care
 - 1. Burden typically placed on Association and Board to prove that director or officer did not exercise ordinary care.
 - 2. Acting in a manner that the officer or director believes to be in the best interest of the Association

IV. Business Judgment Rule

- A. The rule generally provides that a director or officer will not be liable for a decision made in good faith, where the director or officer was:
 - 1. Disinterested;
 - 2. Reasonably informed under the circumstances; and
 - 3. Rationally believes the decision to be in the best interest of the corporation.
(See, Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, 794-796.)
- B. Courts apply the Business Judgment Rule to determine whether the duty of care has been breached.
- C. Courts will generally not review results, just the procedure to get there.

V. Jury Instruction

- A. (Business Judgment Rule Jurisdiction) In reviewing the conduct of the board you are not to consider the ultimate effect of the board's decision but make a determination on whether the board member acted in compliance with his or her duty in concluding to act in whatever manner the Board decided to act.
- B. (Fiduciary Duty) – means a responsibility to ensure
 - 1. A transaction is fair and equitable to the beneficiary; and
 - 2. The fiduciary made reasonable use of the confidence that the beneficiary placed in him or her; and
 - 3. The fiduciary acted in the utmost good faith and exercised the most scrupulous honesty toward the beneficiary and
 - 4. The fiduciary placed the interests of the beneficiary ahead of their own.