SENTRY MANAGEMENT INC.

Fiduciary Responsibility

A fiduciary duty is the highest standard of care at either equity or law. A fiduciary is expected to be extremely loyal to the person(s) to whom he owes the duty (the principal). He must not put his personal interests before the duty, and must not profit from his position as a fiduciary, unless the principal consents.

When a fiduciary duty is imposed, equity requires a stricter standard of behavior than the comparable duty of care at common law. It is said the fiduciary has a duty not to be in a situation where personal interest and fiduciary conflict, and a duty not to profit from his fiduciary position without the express knowledge and consent of the principal. A fiduciary cannot have a conflict of interest, as their only interest is what is best for the principal.

The law of fiduciary responsibility can be viewed as having two purposes. The first is moral or educational in nature. The law sets a standard for appropriate conduct of association directors. It is intended to guide proper conduct and avoid inappropriate actions. If a homeowners association is damaged because of a breach of fiduciary duty by the director, the law affords a remedy to recover the resulting damages. A wealth of resources is available to directors to assist in understanding and meeting their fiduciary responsibilities. Books and educational seminars for continuing education and professional advisors including attorneys, accountants, community association management consultants, engineers, architects, insurance broker are among the paid advisors who may be engaged to advise on either a narrow issue or more broadly to help directors understand and comply with the legal standard of care.

The ability of volunteer directors to effectively perform their fiduciary duties will ultimately determine the success of the common interest or association form of housing. While there are widespread examples of successfully run subdivisions, there are unfortunately also well-known instances of leadership failures where homeowners associations are in political turmoil, financial collapse and physical deterioration. The challenge to each director is to exercise good leadership to avoid such a downward spiral of economic and political self-destruction.

From the legal standpoint, directors incur liability when they breach the standard of care to which they are held under statutory and case law . In reality, suits for beach of fiduciary duty can be viewed as arising from a lack of leadership and management skills by the board of directors.

In successfully run homeowners associations, members of the board of directors possess good communication skills, carefully plan in advance, make good judgments based on sound decision making practices, delegate work to qualified committees or advisors, exercise initiative and independent thinking and work well together as a team. In contrast, political or fiscal failures often result from the acts or omissions of boards of directors lacking good communication skills, procrastinating necessary work, making bad judgments without seeking input from committees or advisors, stagnating for lack of initiative or political stalemates caused by dysfunctional personal relationships among board members. From this perspective, the exercise of fiduciary duty flows naturally from effective business management, and it is the breakdown of good management practices and the lack of skilled leadership that breeds claims for breach of fiduciary duty.

A director must perform his or her duties, including duties as a committee member, in good faith, in a manner the directors believe to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in like circumstances would use under similar circumstances. Compliance with this standard of care immunizes the director from legal liability for alleged failure to perform the individual’s duty as director.

Example of duty:
The challenge of leadership in difficult situations is confronting one's neighbors and friends, imposing financial demands on oneself and one's neighbors, assuming the risk of failure in the controversy and avoiding the lure of procrastination.

A specific case one can make is that of funding reserves. The director must remain focused on the *best interests of the corporation.* Loyalty to the corporation means subordinating personal objectives and needs to the financial *requirements* of the association. Where the financial needs of the association appear to be underfunded, directors may wish to engage a reserve study firm and a funding study preparer to evaluate major components which the association is obligated to maintain and repair and determine appropriate sums for proper maintenance, repair and replacement in the future. Reliance on the advice of a committee, treasurer's report, accountant or reserve study expert in this regard will bring the director within the "safe harbor" of protection. This requires formulating and implementing a plan, after due consideration of funding options and alternatives, which might include regular assessment increases, special assessments with and without membership approval and bank loans. The board must then educate the membership regarding the board's decision making process, and actively advocate the membership vote necessary to implement the board's plan.

The board must also take additional steps to document the exercise of their fiduciary duty. The importance of maintaining good sets of minutes of directors' meetings is well understood.

Nevertheless, critical decisions of the board of directors which involve potential legal liabilities for the association or board, should be given particular attention when the minutes are drafted and approved. The board has an opportunity through the minutes to carefully record its exercise of fiduciary duty. For example a resolution of the board of directors can specifically record the inquiry made by the board, the findings received, the qualification of the consultants contacted, the board's reliance on the consultant's advice and recommendations and consideration for and against the actions which were evaluated by the directors. The resolution acts as a road map to document the board's compliance with the business judgment rule.

By implementing good business management practices, boards of directors reduce the risk of legal claims for breach of fiduciary duty. Good leadership, planning and team work are fundamental ingredients for a successful homeowners association. Claims of fiduciary duty arise where a board procrastinates in taking necessary action to avoid the "unpleasantness" of the difficult decision confronting the Board. The legal standards of conduct must be carefully followed and the ultimate business judgment of the board should be documented in detail in a resolution with specific findings. Industry professionals, consultants and professional management can play key roles in guiding the board through challenging circumstances, whatever they may be.