



**BOARD MEMBER FIDUCIARY DUTY:
A Nuts And Bolts Approach: Part I
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Most board members and community managers have probably heard or been told that a member of the executive board owes a fiduciary duty to the common-interest community association. Most board members and community managers know that fiduciary duty means the board member owes a duty of utmost good faith and fidelity to the common-interest community association. However, there seems to be a dearth of information on what fiduciary duty meant to board members on a practical, day-to-day basis, as they go about performing their duties. This article will provide a simple, straightforward methodology that board members and community managers can use to insure that the board members satisfy their fiduciary duty obligations to the common-interest community association. Perhaps more importantly, following this process will also lead to more thoughtful, reasoned decisions by boards, which will benefit their communities.

What is Fiduciary Duty?

Although the existence of fiduciary duty and its application to the executive boards of common-interest community associations is discussed in numerous court cases, the basic principles are set out in a statute in the Nevada Revised Statutes. NRS 116.3103 establishes that board members owe a fiduciary duty. It provides:

"In the performance of their duties, the officers and members of the executive board are fiduciaries. The members of the executive board are required to exercise the ordinary and reasonable care of directors of a corporation, subject to the business-judgment rule."

Amendments to NRS 116.3103, which went into effect on June 15, 2001, eliminated the lined-out language above.

Fiduciaries owe a duty of undivided loyalty, good faith, honesty and full disclosure. Western Industries, Inc. v. General Insurance Co., 91 Nev.222, 533 P.2d 473 (1975). Fiduciaries have a duty to use their ingenuity, influence, and energy, and to employ all the resources of the corporation, to preserve and enhance the property, even if the interests of the corporation are in conflict with their own personal interest. Nicholson v. Evans, 642 P.2d 727, 730 (1982, Utah). See Leavitt v. Leisure Sports, Inc., 103 Nev. 81, 91, 734 P.2d 1221, 1227 (1987).

The laws governing non-profit corporations (common-interest communities are generally non-profit corporations.) are contained in Chapter 82 of the Nevada Revised Statutes. NRS 82.221, Section 1 provides:

"Directors and officers shall exercise their powers in good faith and with a view to the interests of the corporation."

Together, these statutes and case law set forth three basic prongs which a director must satisfy. First, a director must act in the best interests of the association as a whole. Second, a director must exercise the ordinary and reasonable care of a director of a corporation. Third, a director must act only after reasonable inquire. We will examine each of these prongs in turn.

1. "The Best Interest of the Association"

Although board members are elected to serve on the executive board, a common-interest community association is not a representative form of government. Rather, it is a non-profit corporation and, with some significant exceptions, is governed by the rules and principles that govern all non-profit corporations. This distinction has a profound practical impact.

A director does not represent a constituency in the manner our elected representatives in government do. Instead, a board member must act in the best interests of the association as a whole, and can be held liable by a member of the association for acting in the interests of the minority interests which elected him or her, rather than the interests of the whole community. This does not mean, of course, that reasonable minds cannot disagree on what is in the best interests of the association. It does mean that favoring a minority interest over the interests of the association as a whole can get a director into trouble.

This is a particularly thorny problem for individuals who are elected to the executive board by the builder at the outset of a project. Understandably, these individuals feel an obligation to protect the builder's interests, and it is appropriate for the builder elected board members to prevent unwarranted obstructions in the sales of the builder's units. Indeed, this is why NRS 116.31032 permits a builder to control the executive board until the project is 75% sold out. But any obligation to protect the builder's interest in selling the units is overridden by the fiduciary duty which the individual board members owe to the association, regardless of who elected them. If any individual board member puts the interests of the builder above those of the association, that board member could be personally liable for any damage caused to the association. Thus, executive board members elected by the builder should be especially assiduous in meeting the three prongs of the fiduciary duty standard.

2. "Ordinary and Reasonable Care of the Directors of a Corporation"

The second prong of the fiduciary duty standard is that the director must exercise the ordinary and reasonable care of the directors of a corporation. The standard jury instructions that are given to a jury at trial state that ordinary care means "that degree of care which an ordinarily careful and prudent person would exercise under the same or similar circumstances."

Obviously, this is a somewhat vague standard. How do you judge what some other theoretical person might do under similar circumstances? Fortunately, one clear direction is contained in this standard. A director must act as a "careful and prudent"

person would. That means that the director must act in a conservative manner. A director should avoid risk where possible.

Note that the standard is not that of an extremely careful and prudent person or very careful and prudent person, but of an ordinarily careful and prudent person. In other words, although a director must act in a conservative manner and avoid risk, it is not necessary to go overboard and always choose the most conservative alternative in every instance. A director should merely seek to avoid risk where possible while still achieving satisfactory results.

3. "Reasonable Inquiry"

A director must act only after reasonable inquiry. This is the standard which directors violate more than any other. Surprisingly, it is the standard which can be most easily and certainly satisfied.

What does a "reasonable inquiry" mean? It means that you have to ask questions before you make a decision. We see this principle applied in numerous statutes affecting common interest communities. For example, NRS 116.31083 requires that the executive board review, on at least a quarterly basis, a current reconciliation of the association's bank account and reserve status. Similarly, under NRS 116.31152, the directors are obligated to cause a study of the reserve account requirements to be conducted every five years and to review that study at least annually. These statutory provisions are merely specific applications of the more general principle that a director, to fulfill his or her fiduciary duties, must make reasonable inquiry. ♦

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