

EchoJournal

A Journal for Community Association Leaders

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Ethics for Board Members

The purpose of this article is to provide community association board members with practical tools designed to identify and implement ethical value systems for their association. These tools will enable board members to navigate through the complex ethical issues that can occur in the everyday administration, management and governance of a condominium project, planned development or other community association.

Ethical Dilemmas—An Introduction

Many ethical dilemmas faced by board members on a daily basis are not clear-cut. In fact, there are often no “right” or “wrong” answers to an ethical dilemma. That said, how you deal with an ethical dilemma says a lot about you, your board and your association.

Ethical dilemmas often fall within a “grey” area. These dilemmas are not “black and white” and can often be argued in multiple ways.

According to Kenneth Blanchard and Norman Vincent Peale, authors of *The Power of Ethical Management*, there are three questions persons should ask themselves when faced with an ethical dilemma:

1. Is it legal? (In other words, will any criminal or civil laws, association governing document provisions or

board policies be violated by engaging in an action?)

2. Is it balanced? (Is it fair to all parties concerned both in the short term and the long term? Is it a win-win situation for those directly and indirectly involved?)

3. Is it right? (How does this decision make you feel about yourself? Are you proud you made this decision? Would you like others to know you made this decision? How will this decision look five years from now?)

Most of the time, when dealing with “grey” decisions, answering just one of these questions is not enough. However, if you take the time to reflect on all three questions, the answer becomes clear as to the most ethical course of action.

With the onset of recent visible and highly reported ethical violations in corporate America (think of the decisions made by many people heading companies and agencies leading to the recent sub-prime mortgage meltdown), today’s ethics landscape is treacherous and complex. A common perception today is that businesses of all sizes, types and ownership show little, if any, meaningful reduction in the risk of unethical behavior.

Volunteer community association boards have the same fiduciary duties

as boards of large corporations such as McDonald’s, Intel and Texaco. The difference is that your conduct will be compared to other non-profit mutual benefit corporations’ board members. It may even come under scrutiny in a court of law.

To maintain protection from liability as volunteer directors, board members have a fiduciary duty to act (1) in good faith, (2) in the best interests of the association and (3) using such care, including reasonable inquiry, as an ordinarily prudent person would under similar circumstances. This requirement is codified in California Corporations Code §7231.5.

It is important for all board members, especially a new board member with no prior director experience, to research and understand their fiduciary duties to ensure that they are acting ethically in order to properly protect their individual actions and the actions of their board and the association. Assume this reasonable inquiry is needed to satisfy number 3 above.

While ethical dilemmas will always be present, an association’s board can take actions and create tools to ensure that when an ethical dilemma arises, board members will have a standard to gauge their behavior and decisions.

The Practice of Ethics

In a nutshell, the practice of ethics by a board member involves knowing what behavior and conduct is right or wrong in the governance of their association and doing what is right. Ethics is what you do when no one else is looking.

Ethics are the “moral compass” and standards recognized in the performance of a director’s duties and responsible governance of an association. These standards are established, in part, in the California Corporations and Civil Codes.

Boards should adopt a code of ethics, or at a minimum a code of conduct, to establish a standard for how the board conducts itself and the business decisions of the association:

- This code defines the value system of the association and how directors must behave.
- A code of ethics/conduct clarifies ethical standards regarding loyalty, fidelity, integrity, honesty, confidentiality and competency.
- Having established ethical standards will enable board members to avoid some potential “grey” areas.
- A code of ethics should incorporate preferred business practices, appropriate legal requirements and the expected code of conduct for board members.
- The code of conduct should be distributed not only to the board, but also to the homeowners. This will make the board’s actions accountable to each other and the homeowners. This kind of transparency is a win-win for directors and owners. A sample Board Member Code of Ethics is shown on page 14.

In the community association context ethics are involved in a number of relationships and interactions:

- Between individual board members
- Between the board and the association
- Between the board and homeowners/ residents
- Between the board and management
- Between the board and association experts and consultants (i.e. association legal counsel, financial and tax advisors, reserve study providers, etc.)

- Between the board and vendors

The board should be focused on the main purposes of the association, namely to:

- Protect and preserve the association’s common areas and other real, personal, and intangible assets.
- Manage the association’s finances, including meeting statutory budgeting and disclosure requirements, providing for reserve funding and pursuing assessment collections.
- Promote the homeowners’ unimpeded and safe use and enjoyment of the association’s common areas, exclusive use common areas and separate interests.
- Enforce the association’s governing documents.

Sometimes not doing something can be a breach of a board member’s ethical duties. That said, purposefully choosing to not do something for the best interests of the association is different. Board members cannot turn a “blind eye” to matters affecting the well being of the association, or which can place the board or association at risk. No decision is a decision.

Ethical behavior is based on observations and perceptions—board members need to “walk the walk” as well as “talk the talk.” Ethical standards imposed on and expected of the board are only as good as their adherence by board members.

It is not sufficient to issue platitudes as to what is and what isn’t ethical behavior. Board members should be held accountable for their actions, and it should be demanded by their peers that they implement ethical behavior.

The Business Judgment Rule

The Business Judgment Rule is a presumption that directors’ decisions are based on sound business judgment, which can be rebutted only by a factual showing of fraud, bad faith or gross overreaching. Acting in accordance with the Business Judgment Rule is an indication that a board member is likely acting ethically.

Application of the Business Judgment Rule in the 1999 California Supreme Court case, *Lamden v. La Jolla Shores Clubdominium Homeowners Association* (21 Cal.4th 249):

- The court held that it will defer to a board’s authority and presumed expertise in discretionary decisions regarding the maintenance and repair of a common interest development, provided the board’s decisions are:

- Based upon reasonable investigation;
 - Made in good faith and with regard to the best interest of the association; and
 - Within the scope of authority given to the board under the relevant statutes and CC&Rs.
- Assuming that a board was found to have acted in accordance with these factors, then the board would seemingly have committed no wrongs in performing whatever action was being questioned.

Acting upon/after reasonable investigation and inquiry:

- A director should independently investigate and evaluate facts particular to a situation before acting.
- A director should consult with experts or consultants (i.e. legal counsel, financial manager, reserve study provider, etc.) when it is prudent to do so.
- A director is entitled to rely on information, opinions, reports or statements prepared by experts and consultants.

Acting in good faith and in the best interests of the association:

- Directors cannot make decisions that benefit their own self-interests.
- Directors must make their decisions ensuring that those decisions do not adversely affect the association financially, legally or otherwise.
- Directors cannot act in the best interests of a particular group or minority interest of an association. Directors should also, pursuant to their fiduciary duties under Cal. Corp. Code §7231 (a), act as an ordinarily prudent person in a like position would:
- Acting with the level of care that persons of ordinary prudence would use in order to avoid injury to themselves or others under similar circumstances.
- Acting in a conservative manner, minimizing risks where they can rea-

sonably be avoided in the same manner that a “prudent” person would.

- The benchmark is the basic attributes of common sense, practical wisdom and informed judgment.

Highlighted Duties of Directors

Duty of Knowledge—The board is responsible for enforcing the association’s governing documents, so board members should know the contents and requirements of the association’s governing documents (Articles of Incorporation, CC&Rs, Bylaws, operating rules, architectural guidelines). The board is also responsible for managing the daily affairs of the association, so the board should be continually reviewing and evaluating association business, records and transactions.

Duty of Financial Management—The board is responsible for managing the finances of the association, including the levying and collection of homeowner assessments, review of financial records and distribution of required disclosures.

Duty of Maintenance—The board is responsible for the maintenance, repair and replacement of the association’s common area components (i.e., exterior and structural portions of the association’s buildings and improvements). The board should be aware of and plan for potential and actual deferred maintenance issues.

Duty of Operation—The board is responsible for the operation and management of the common area facilities and amenities, such as pools and clubhouses. The board is also responsible for contracting and paying for services for the association (i.e. janitorial services, landscaping, utilities, etc.). And boards need to deal with foreclosed properties and abandoned units sitting vacant that the current owners are not properly maintaining.

Duty of Enforcement—The board is responsible for enforcing the association’s governing documents, including: enforcement of use restriction violations; delinquent assessment collection (the board should assess late charges, interest and collection costs for the collection of delinquent assessments); and architectural restrictions. The board is also responsible for impos-

ing suspension of voting rights and membership privileges as a disciplinary action against homeowners for violation of the governing documents, if allowed under the governing documents, and this discipline should be applied uniformly and consistently. Directors should be aware of their responsibility in neighbor-to-neighbor nuisance disputes versus association to owner disputes.

Duty of Leadership—An effective and ethical board members is:

- Future oriented.
- A team player.
- Self-disciplined.
- An active participant.
- An appropriate delegator.
- Open and willing to learn about the community and their duties.
- Connected to the community and its values.
- Passionate about the success of the association and its members.

Examples of Ethical Dilemmas

Unruly board members who are not acting in the best interest of the association:

- Not enforcing the association’s governing documents (including not enforcing delinquent assessment collection policies).
- Acting in a disparate or discriminatory manner towards certain homeowners.
- Advancing self-serving interests to further their own agenda (which would be a conflict of interest).
- Improper corporate governance (i.e. not following the requirements of the association’s governing documents or statutory requirements).
- Not following the Business Judgment Rule.
- Violating the association’s governing documents. Dependant on governing document authority, this can lead to declaring the seat of a director vacant.
- Breaking the attorney-client privilege and/or distributing confidential corporate/business records.
- Embezzlement—“Borrowing” permanently or temporarily from the association’s funds.

The above board members need to be educated on and/or reminded of their fiduciary duties, statutorily

required standard of care and the code of ethical conduct adopted by the board. Peer pressure can be an effective tool to curb unethical behavior—other board members should confront the offending board member to address ethical issues.

Unruly homeowners who are placing the association at risk:

- Harassment of association employees, independent contractors and vendors. The association is in an employer-employee relationship, and that harassment can create a hostile workplace at the association and expose the association to potential legal liability. Board members must make sure that they do not create a hostile work environment.
- Damage to the association’s common area. The board has a duty to repair and maintain the common area.
- Continued use violations under the governing documents. The board has a duty to enforce the association’s governing documents, and the board should impose discipline as appropriate.
- Failure to pay assessments. The board should aggressively follow the association’s collections policy to ensure for the financial viability of the association.

Conclusion

The principles behind ethical rules are to guide people in the performance of their duties and express the basic tenets of ethical and professional conduct. A code of conduct for a board can be an invaluable tool to ensure that board members are aware of the “line in the sand” when it comes to grey matters and turn an otherwise confusing situation into a clear decision. To ensure that the association and board are protected, a director should act ethically at all times. Ethics are yours to adopt—if you don’t do it for yourself and your board, no one will. [E]

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