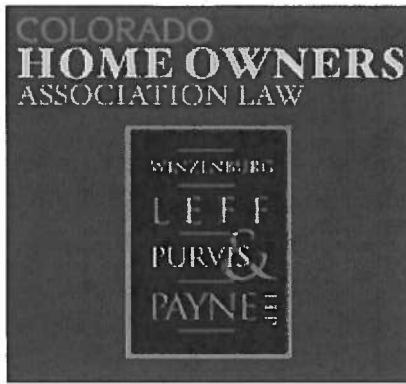




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Fiduciary Duties of Board Members: An Overview

Board members and managers often ask us to explain the fiduciary duties of board members to the community associations that they serve. We have compiled some information to guide directors in their roles. As you read this information, you will discover that, at the most basic level of decision-making, directors must make reasonable decisions after considering the information available. In advising boards, we recommend that directors try to recognize the emotions involved in a given situation and avoid letting the emotions, rather than the facts and interests of the association, guide the decision-making process.

What is a fiduciary? Webster's Dictionary defines "fiduciary" as follows:

adj. of, relating to, or involving a confidence or trust: as **a** : held or founded in trust or confidence **b** : holding in trust **c** : depending on public confidence for value or currency

Fiduciary duties arise from special relationships that the law recognizes. Examples of fiduciary relationships include doctor-patient, attorney-client, trustee-beneficiary, and board of directors-corporation.

What duties must board members of nonprofit corporations uphold?

Duty of Care. Community association boards must give the business of their associations the same degree of care and diligence that prudent persons would exercise in their own affairs in similar circumstances. The duty of care requires directors to invest time and attention in association business, make reasonable inquiry into association matters to enable informed decision-making, and take reasonable, not arbitrary or capricious, actions.

Duty of Loyalty. Directors of community associations, like their counterparts in for-profit corporations, have a duty to the association and to its members to act for the association's benefit only and with an eye to its best interests, without regard for any personal interest the directors may have. Courts take this duty very seriously, using expressions such as "utmost good faith." If a transaction is challenged, courts place the burden on the director to demonstrate the fairness of any transaction in which the director is personally involved.

Duty to Act within the Scope of Authority. Directors owe a duty to their associations and to their members to perform their duties in accordance with the authority granted to them by statute and in their governing documents. If directors exceed this authority and damage results, the directors may be personally liable for their unauthorized actions.

How do Colorado statutes address the fiduciary duties of nonprofit corporation board members?

Colorado statutes address the fiduciary duties of nonprofit corporation board members. The Colorado Revised Nonprofit Corporation Act ("Nonprofit Act") governs most community associations in Colorado. The Nonprofit Act states the general standards of conduct for board members, as excerpted below:

7-128-401. General standards of conduct for directors and officers.

(1) Each director shall discharge the director's duties as a director, including the director's duties as a member of a committee of the board, and each officer with discretionary authority shall discharge the officer's duties under that authority: (a) In good faith; (b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (c) In a manner the director or officer reasonably believes to be in the best interests of the nonprofit corporation.

(2) In discharging duties, a director or officer is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by: (a) One or more officers or employees of the nonprofit corporation whom the director or officer reasonably believes to be reliable and competent in the matters presented; (b) Legal counsel, a public accountant, or another person as to matters the director or officer reasonably believes are within such person's professional or expert competence; (c) Religious authorities . . . ; or (d) In the case of a director, a committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

How will a court likely consider a board decision if challenged by members of the association?

In Colorado, the courts often apply the Business Judgment Rule when evaluating board decisions. The Business Judgment Rule serves as a defense for directors. To prevail when using the Business Judgment Rule as a defense, a board of directors must show that it acted in good faith, in a way that was reasonable under the circumstances and that was not arbitrary or capricious. When applying the Business Judgment Rule, a court recognizes that board members must make decisions based on the information available at the time the decision-making occurs; accordingly, courts generally refuse to interfere with honest business decisions through the benefit of hindsight. The Business Judgment Rule will not apply when the board failed to make a decision on a matter. It also will not benefit directors who hold an interest in the matter decided upon by the board or who otherwise act improperly or outside the scope of their authority as directors.

Does Colorado law allow nonprofit corporations to protect their board members from liability if a challenge occurs?

Yes. Colorado statutes offer protections to nonprofit corporation directors and officers by allowing the corporate articles of incorporation or bylaws to eliminate or limit the personal liability of a director to the nonprofit corporation or to its members for monetary damages resulting from a director's breach of fiduciary duty. Corporate protections for board members also come in the form

of directors' and officers' liability insurance, indemnification provisions in the governing documents, and sound business practices.

What types of director actions do not receive protection by statute or in corporate documents?

Colorado statutes state that a nonprofit corporation's corporate documents cannot eliminate or limit the personal liability of a director for the following: (a) monetary damages for any breach of the director's duty of loyalty to the nonprofit corporation or to its members; (b) acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; (c) unlawful distributions of the corporate assets, including loaning corporate funds to a director or officer; or (d) any transaction from which the director directly or indirectly derived an improper personal benefit.

What actions can community association boards take to limit claims that they have breached their fiduciary duties?

In general, we offer the following advice to community association board members:

- Understand the association and its operations
- Devote time to association business and actively participate in decision-making
- Select and support good management
- Seek the advice of professionals and listen to the advice those professionals give
- Avoid making decisions solely based on popularity or to quiet dissension among neighbors
- Serve the association altruistically, without compensation or special treatment
- Conduct business at arm's length and for the association's benefit, not your own
- Document the decision-making process in the association's minutes, including professional advice received, for all major decisions

If you serve on a board or manage a Colorado community association and have questions about the fiduciary duties of board members or other association legal matters, you may contact one of our attorneys for further information and guidance.