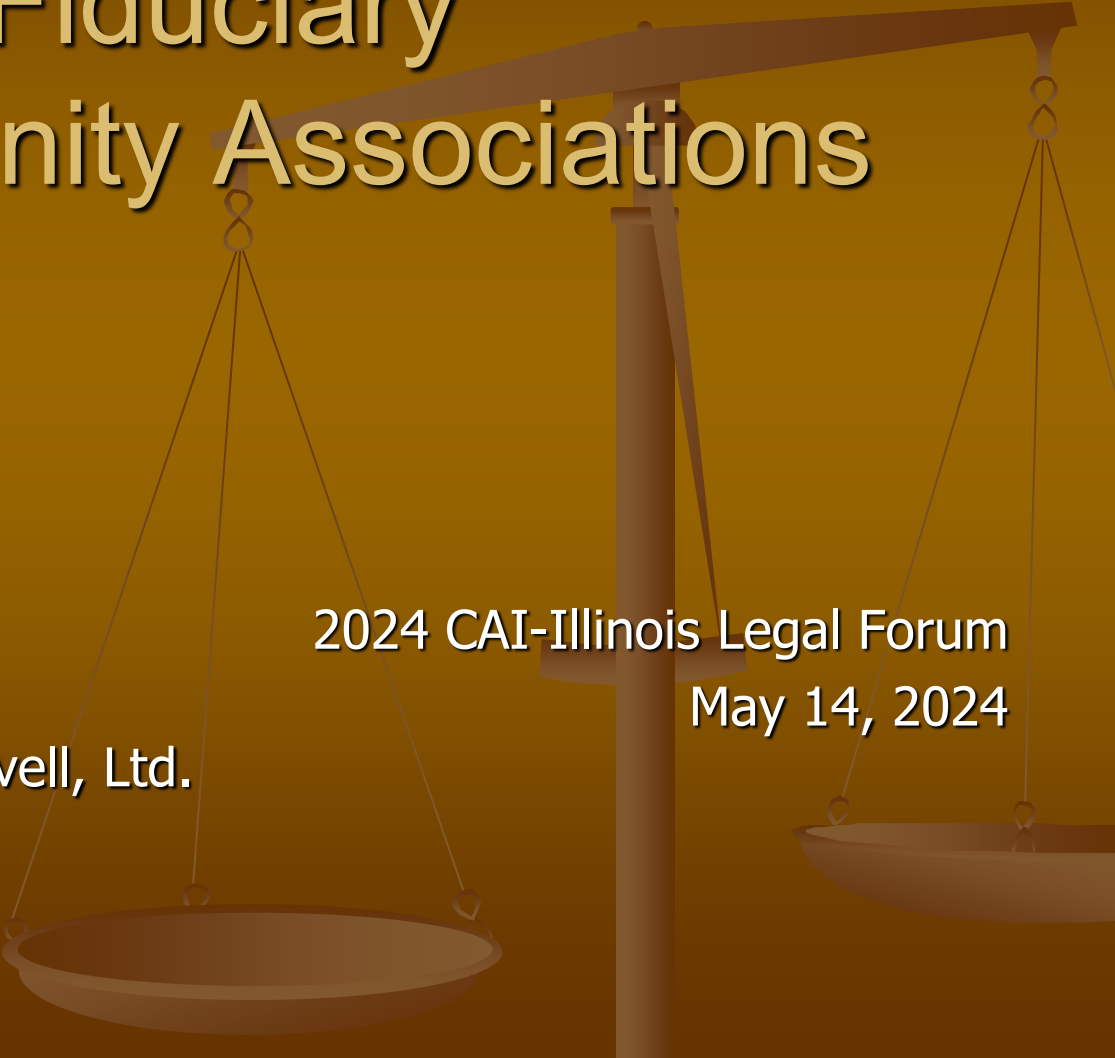


What it Means To Be A Fiduciary In Community Associations



Marshall N. Dickler

James A. Slowikowski

Dickler Kahn Slowikowski & Zavell, Ltd.

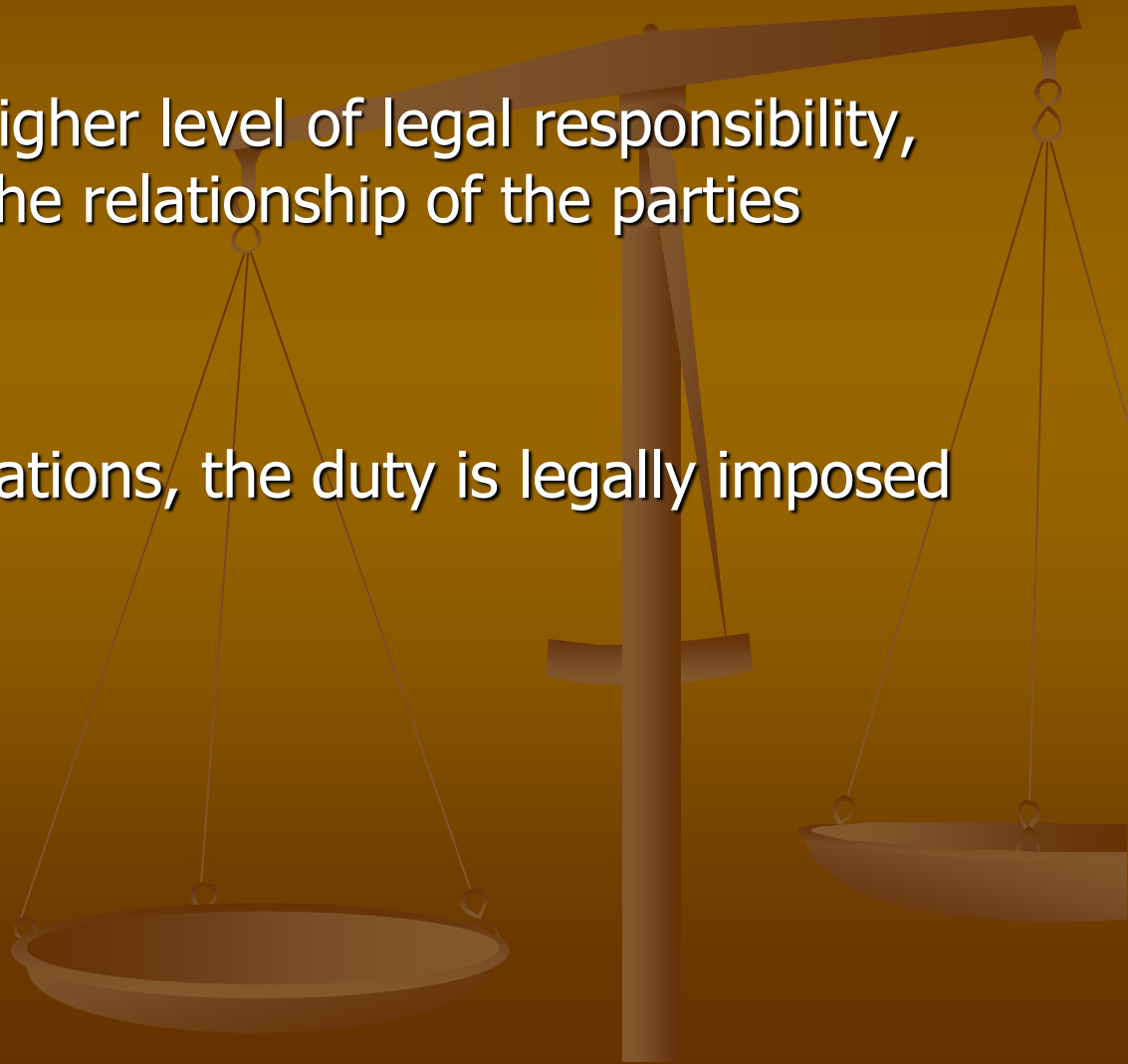
2024 CAI-Illinois Legal Forum

May 14, 2024

Fiduciary What?

Fiduciary Duty – A higher level of legal responsibility, arising from the relationship of the parties

In Community Associations, the duty is legally imposed by law in two ways:



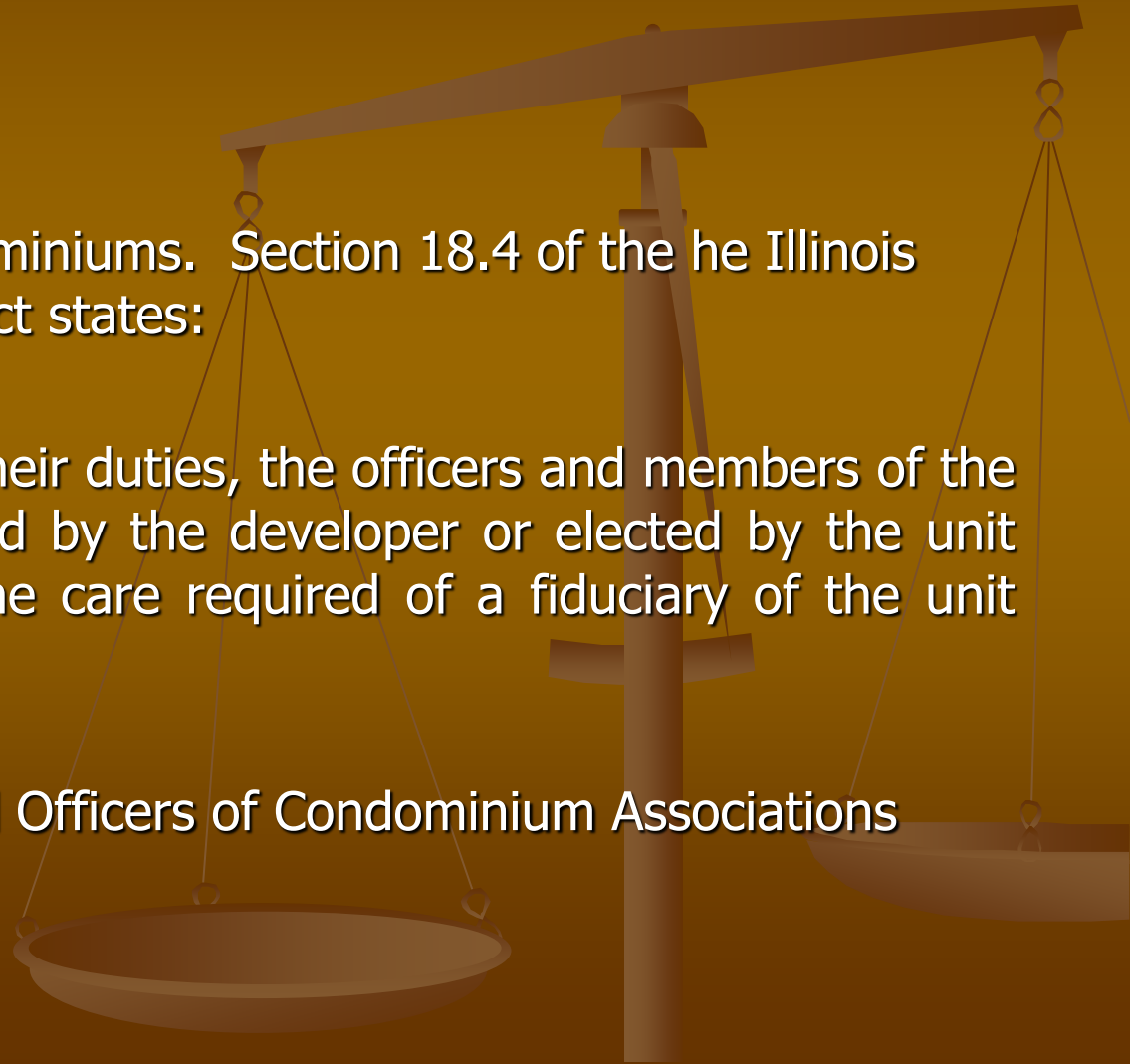
Fiduciary Duty

Creation of Legal Duty :

1) By statute in Condominiums. Section 18.4 of the Illinois Condominium Property Act states:

“In the performance of their duties, the officers and members of the board, whether appointed by the developer or elected by the unit owners, shall exercise the care required of a fiduciary of the unit owners.”

Applies to: Directors and Officers of Condominium Associations



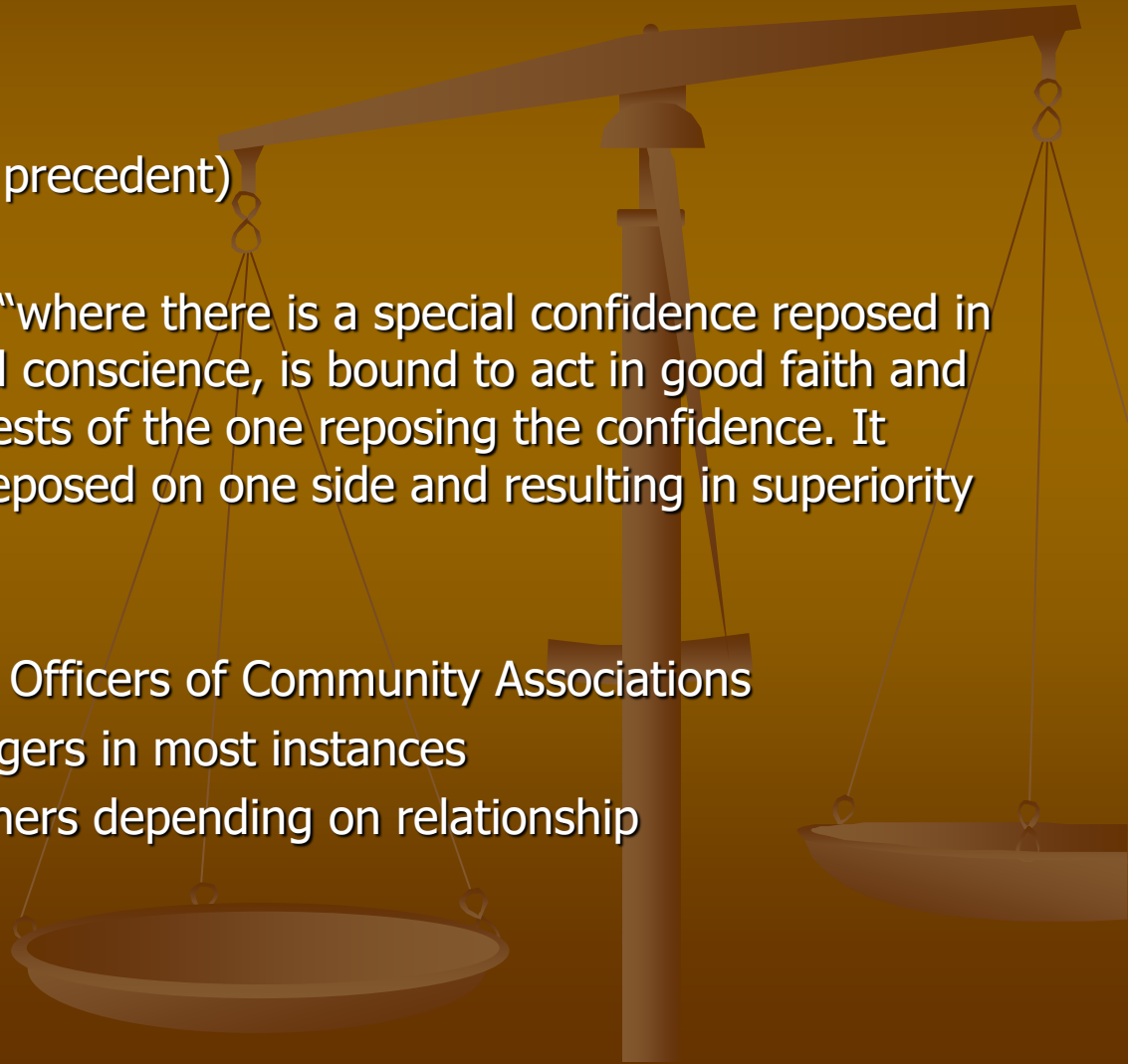
Fiduciary Duty

Creation of Legal Duty :

2) “Common Law” (court precedent)

Fiduciary relationship exists “where there is a special confidence reposed in one who, in equity and good conscience, is bound to act in good faith and with due regard to the interests of the one reposing the confidence. It exists where confidence is reposed on one side and resulting in superiority and influence on the other.”

Applies to: Directors and Officers of Community Associations
 Property Managers in most instances
 Potentially others depending on relationship



Fiduciary Duty

A Fiduciary Duty is . . .

- Part 1:

A duty of “undivided loyalty”

The responsibility to act in the best interests of the association only, as a whole.

Not personal interests.

Not personal interests of a few owners.

Not interests of related entities, i.e.,
master association vs sub-association



Fiduciary Duty



A Fiduciary Duty is . . .

Directors have “strict duties to treat the unit owners with the utmost candor, rectitude, care, loyalty and good faith – in fact to treat them as well as he would treat himself.”

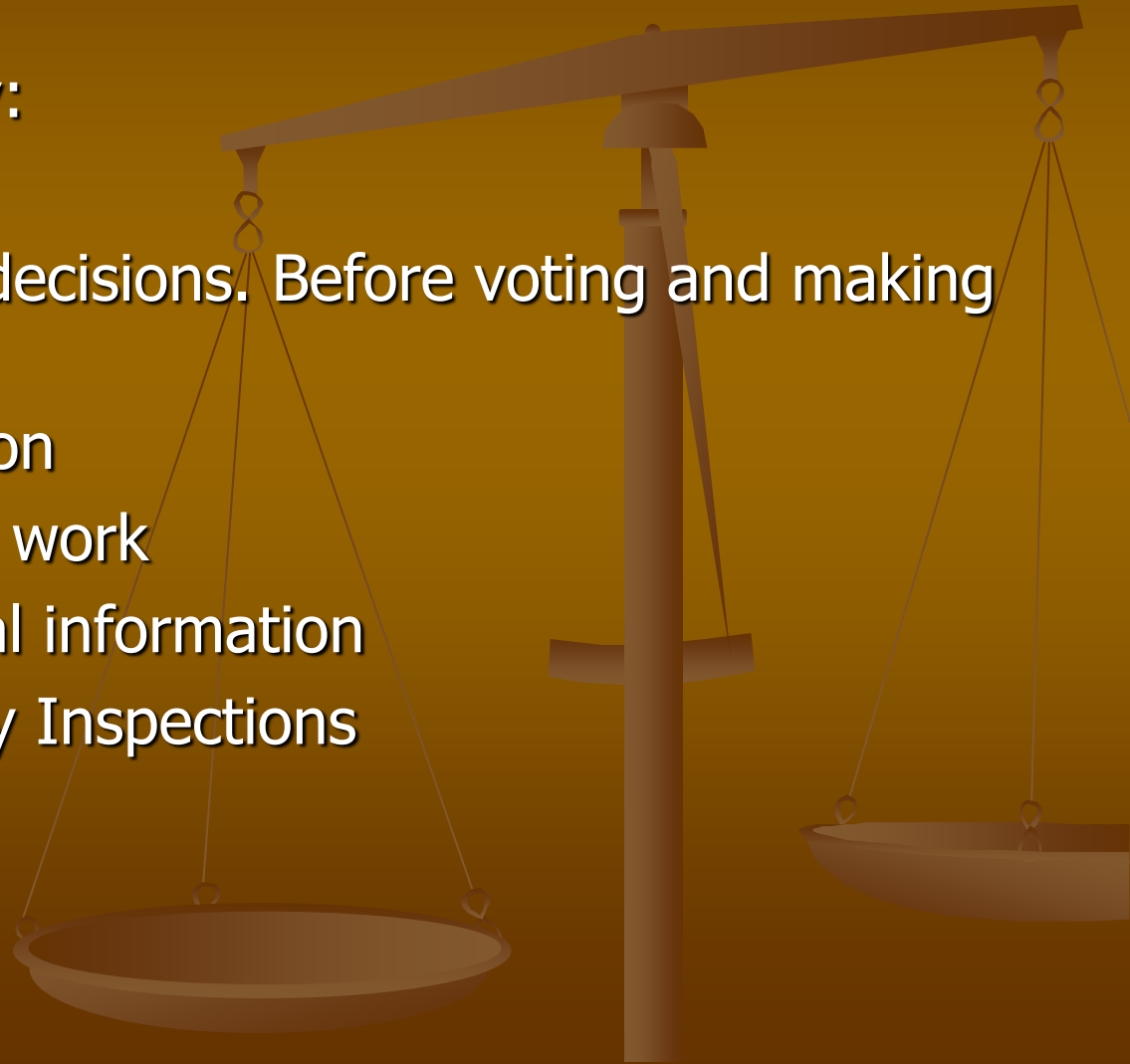
- Part 2:

The Business Judgement Rule: Exercising Reasonable Business Judgment

Fulfill the responsibilities by “exercising due care” in the performance of your duties.

Fiduciary Duty

- Exercise Due Care by:
 - Making informed decisions. Before voting and making decisions:
Gather information
 - Bids for work
 - Financial information
 - Property Inspections



Fiduciary Duty



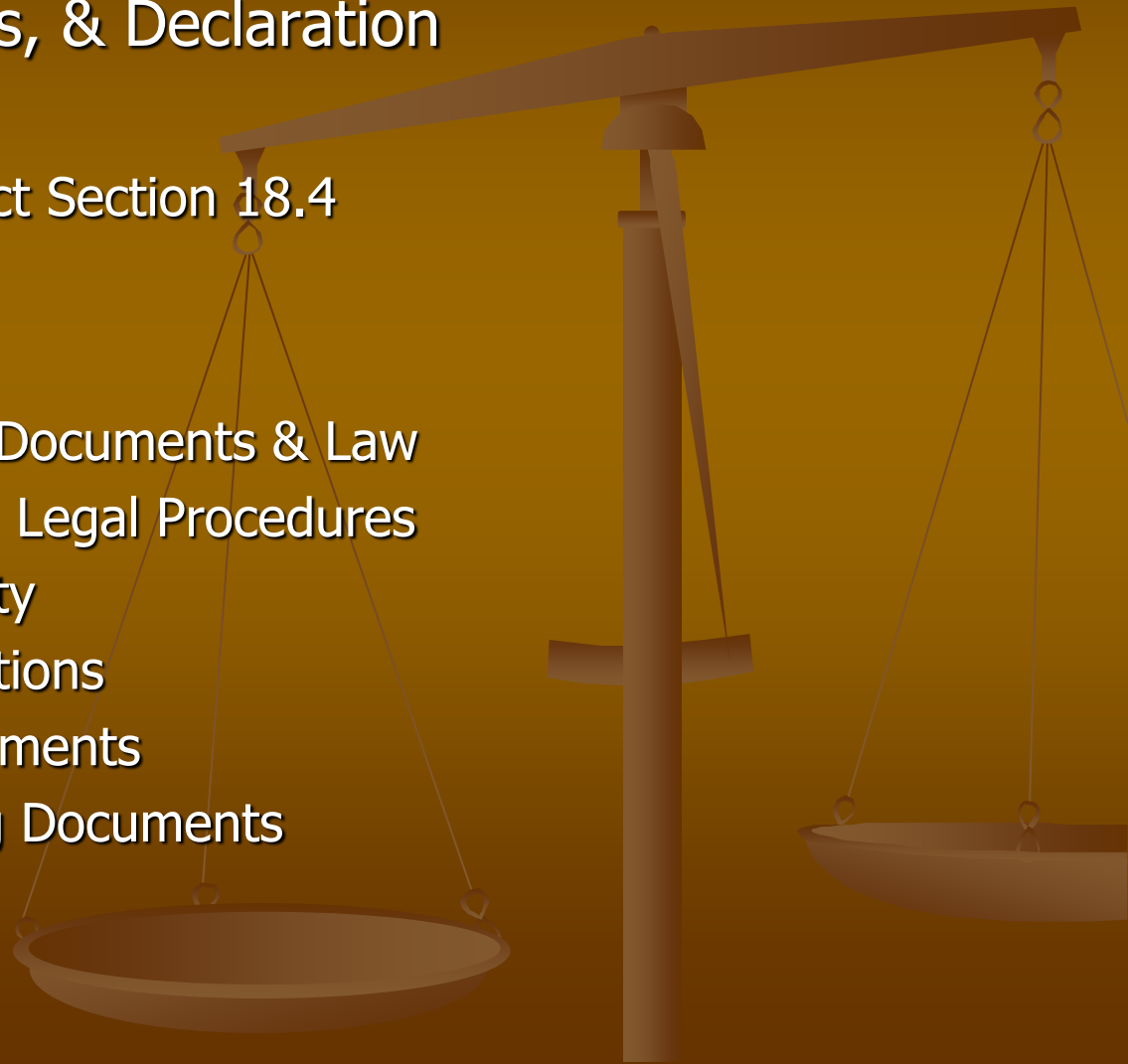
- Making informed decisions. Before voting and making decisions:

Information from Professionals

- Property Manager input and advice
- Legal opinions; contract review
- Engineers – property inspection & reports
- Reserve Studies
- Property Manager input, advice, reports
- Accountants; annual audit/review

Particular Responsibilities

- - Contained In Bylaws, & Declaration
- - Imposed by law
 - Statute - Condo Act Section 18.4
- General Examples
 - Follow Governing Documents & Law
 - Operate as Board; Legal Procedures
 - Fiscal Responsibility
 - Day to Day Operations
 - Repairs & Replacements
 - Enforce Governing Documents



And The Court Survey Says . . .

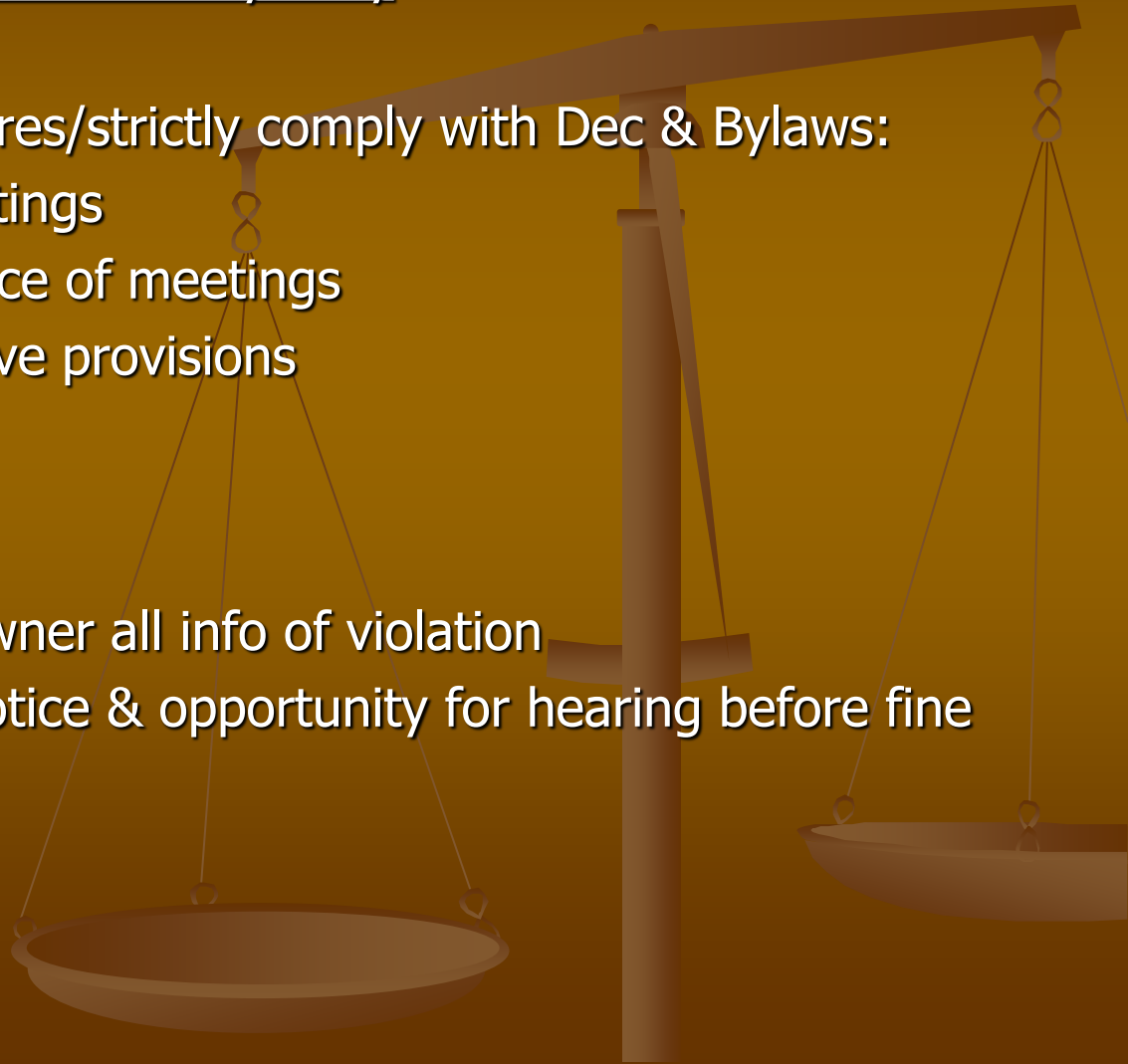
- Court Findings of Breach of Fiduciary Duty

Failure to follow procedures/strictly comply with Dec & Bylaws:

- Not having open meetings
- Failing to provide notice of meetings
- Failing to follow reserve provisions

Violations

- - Failure to provide owner all info of violation
- - Failure to provide notice & opportunity for hearing before fine



And the Court Survey Says . . .

- Court Findings of Breach of Fiduciary Duty

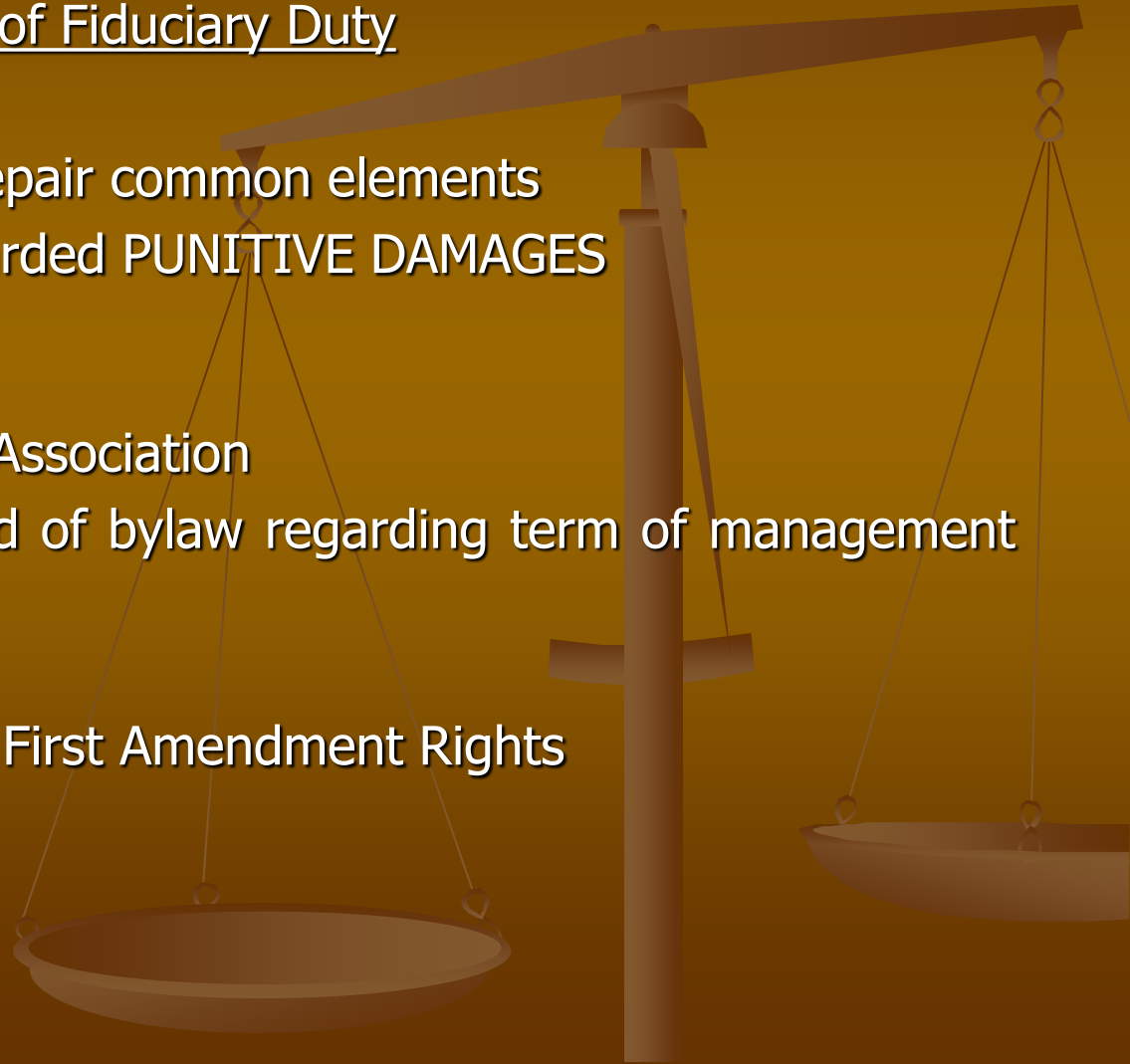
Failure to maintain and repair common elements

- At least one case awarded PUNITIVE DAMAGES

Management (duties to Association

- Failure to advise board of bylaw regarding term of management contract

Board Interference with First Amendment Rights



And the Court Survey Says . . .

- Court Findings of Breach of Fiduciary Duty

Unreasonable delays and conditions to remodel unit

Wrongfully reject candidates for election for alleged violations
(good standing)

Failure to Provide Records for Inspection

Failure to Obtain Sufficient Insurance



And the Court Survey Says . . .

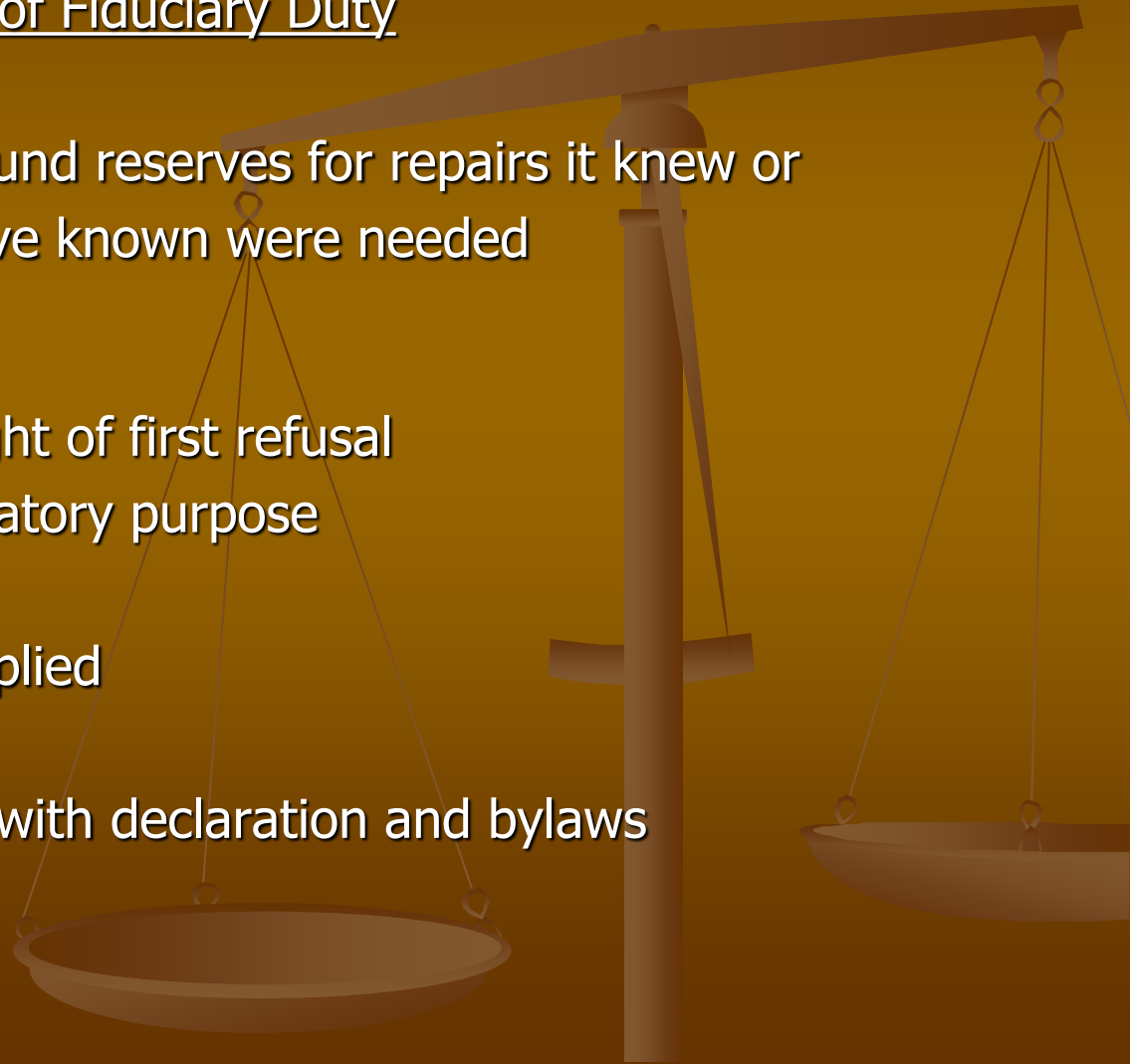
- Court Findings of Breach of Fiduciary Duty

- Developer – failure to fund reserves for repairs it knew or reasonably should have known were needed

Improperly exercise right of first refusal
-Use ROR for discriminatory purpose

Rules not uniformly applied

Not strictly complying with declaration and bylaws



Take Aways To Avoid Breach

Exercise Business Judgment & Due Care:

Act Properly As A Board

All decisions by board; open meetings; notice

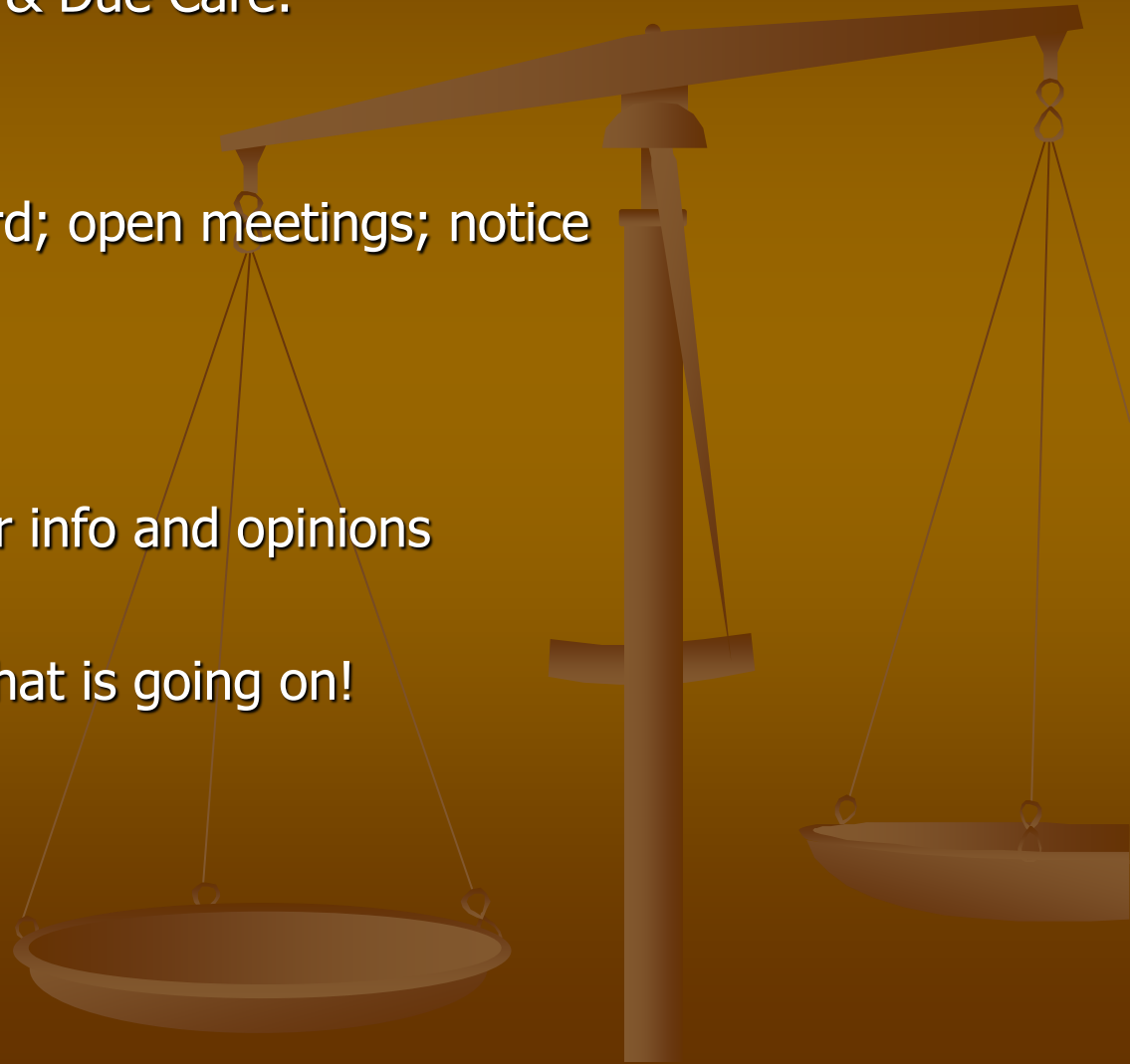
Informed Decisions

Gather information

Use professionals for info and opinions

Act timely

Be Aware – know what is going on!



HAVE A GREAT SUMMER!



Directors and Officers Responsibilities

ASSOCIATIONS ARE CORPORATIONS

All common interest communities, including condominium associations, are corporations or have all of the rights, powers, and duties of a corporation. The Illinois Condominium Property Act imposes all of the powers, duties, and obligations of an Illinois corporation on all condominium associations. Corporations are operated by their directors and officers. In associations, generally the directors do even more than is done by other corporate directors. They perform all of the functions on behalf of the association, although they may delegate specific tasks to the officers or to others. Association members are like shareholders. They have an interest in the corporation as a result of their ownership. They do not run the association. They do not conduct the association affairs. They cannot control the association's activities.

In Illinois and generally, fiduciary duties imposed upon board members include two (2) components. The first component is undivided loyalty. The second component is reasonable business judgment in conducting the business affairs of the association.

Undivided loyalty means that each board member must view what is needed by the association and/or in the best interest of the association. They cannot look at their own needs, perceptions, or beliefs. They cannot look at the needs, perceptions, or beliefs of other owners. They are required to look at the needs and requirements of the association, as set forth in its documents, as set forth by statute, or as necessary in order for the association to continue to accomplish its purpose. Undivided loyalty may mean that a board member votes for an increase in assessment or for greater reserves even though the board member personally cannot afford to pay the increased assessment. Similarly, a board member must vote on matters where the board member believes it is necessary or appropriate, even though many, and sometimes all, owners do not wish to see the association proceed with that which is being voted on.

Fiduciary Duties

Reasonable business judgment in conducting the business and functions of the association is the second requirement of fiduciary duty of directors. Each director must understand the association business and must actively participate in that business. Each director must analyze each activity of the association, determine what is necessary or required for the association to operate, and then must vote with other directors to perform that function. Each director must exercise independent judgment and knowledge in performing each and every activity. That means they must understand the activity to be performed, must understand the choices and options available with respect to that activity, and then must use reasonable business judgment in determining which choice or selection is appropriate with respect to each activity. For example, securing three (3) bids from three (3) separate contractors on specific work is not mandated anywhere in any law. However, it is a reasonable approach by a director to determine what is a fair price to pay for work. Of course, the director must be certain that all three (3) bids are based upon the same work. The director must understand that the specifications for the work are the same or substantially the same. The director must carefully review each bid and submission to confirm they are the same and that the director is making an equal comparison. That is acting in a reasonable and business like fashion. Each director should understand that when they are representing an association, they cannot summarily choose a course of action or hire someone based upon their sense that they like someone. They cannot summarily sign a quotation, which obligates them to pay for something but may not



impose any obligations on a seller. They must have a review of the documents by their attorney. They must contract using contracts that protect the association adequately, and they must utilize all resources available including management, lawyers, accountants, engineers, and architects to provide input and assistance that is necessary in order to effectively make business judgments. They cannot delay excessively or ignore obligations. The fact that these matters may cost money does not change or eliminate the need to perform those functions. The operation of an association by its directors is not something that is accomplished using only the sweat equity of the directors, or by the seat of the pants of the directors, or by doing nothing. To do so exposes the directors to charges of breach of fiduciary duty, and to liability for failing to adequately act in the interest of the association.

CONDOMINIUM PROPERTY ACT SETS FORTH SPECIFIC DUTIES

In addition to the general standards and requirements set forth above, the Condominium Property Act, the corporation act, and most declarations set forth specific duties to be performed by the association through the board of directors. The Condominium Property Act (CPA) sets these duties out specifically at Section 9, Section 18, and Section 18.4 of the Act, although some duties are set forth at other portions of the Act. Common interest communities have some specific duties set out in the Illinois Common Interest Community Association Act (CICA). In addition of course, all declarations set forth specific duties to be performed by the board. Section 18.4 (a) through (q) of the Condominium Property Act is a good listing of the duties and is restated in part as follows:

1. To provide for the operation, care, upkeep, maintenance replacement, and improvement of the common elements.
2. To prepare, adopt, and distribute the annual budget.
3. To levy and expend assessments.
4. To collect assessments from unit owners.
5. To provide for the employment and dismissal of personnel necessary or advisable for the maintenance and operation of the property.
6. To obtain adequate or appropriate kinds of insurance.
7. To own convey or otherwise deal with the units or lots.
8. To adopt rules and regulations regarding the use of the property.
9. To keep detailed accurate records of the receipts and expenditures affecting the use and operation of the property.
10. To have access to each unit from time to time as necessary for repair and maintenance of the common elements.
11. To pay taxes or other special assessments.
12. To impose charges for late payment and to levy fines for violations of the declaration, by-laws, rules and regulations of the association.

Failure to perform these functions adequately or timely in a reasonable and business like fashion would be a breach of duty by the board members as a matter of law. These are also good guidelines for Common interest communities.

Directors have a special duty to the association that they operate. In Illinois the directors have a fiduciary duty to comply with specific requirements in the declaration. If the board members fail to comply with the clear declaration requirements, they can be held in breach of their fiduciary duty. This principal was stated in a case dealing with an association's alleged failure to proceed in



accordance with the first purchase option requirements in the declaration. Illinois law requires that directors cannot do anything that would interfere with the ability of the association to accomplish its purpose. Doing anything which interferes with the association's ability to accomplish its purpose is a violation of the directors' obligations as a matter of law. This principal was set forth in a case where the developer board did not adequately reserve on behalf of the association.



DIRECTORS - - - OFFICERS ARE THEY THE SAME

In all associations, there are officers in addition to directors. Generally, the officers are elected by the directors. The directors, by vote at board meetings, vote on substantially all activities of the association. The officers carry out their specifically authorized duties, and also see to the day to day functions of the association as directed by the board or as necessary to continue to operate the association. In a condominium association, they are elected only from among the directors so that each officer is also a director. Each association should have at least a president, secretary, and treasurer.

The **president** conducts board meetings and annual meetings. That does not mean that the president controls the meeting. The entire board, including the president, functions at a meeting. The president handles the day to day activities of the association dealing with management, vendors, other officers and directors. The president's function includes signing contracts as directed by the board and overseeing or supervising all business activities.

The **secretary's** duty is to maintain the business records of the association. The secretary may take minutes or may have them taken by another. However, the secretary keeps the minutes, other business records, and documents and maintains them for the association. This would include, in addition to minutes, all other corporate papers, all contracts, correspondence, communications, insurance, unit owner files. Basically, every association document is kept by the secretary. Of course, these documents are, more often than not, maintained by management. However, the secretary has responsibility for them and for directing management with respect to maintaining all business records of the association.

The **treasurer** maintains all of the financial records and documents of the association. Again, most often these documents are maintained by management. However, the treasurer does have authority over all financial records of the association. The treasurer may or may not have signatory on financial accounts of the association. The treasurer may or may not have signatory authority alone or in conjunction with one or more other officers or directors, including the president. The treasurer may have signatory authority along with other officers and/or management. Whether the treasurer has signatory authority or not, the treasurer is responsible for those accounts. Similarly, the treasurer is responsible for any other savings accounts, certificates, or any and all funds of the association. The treasurer's function is to keep track of and report on the financial condition of the association at each board meeting and at the annual meeting. The treasurer reports income, expenses, balance sheets, and all other financial information. The treasurer reports transfers in financial resources. The treasurer presents to the board options and alternatives with respect to investment of funds, and acts at the direction of the board with respect to investment of association

funds, but within the parameters that are allowed by investing on behalf of associations. The treasurer oversees all financial books, records, all accounts receivable, all accounts payable, the general ledger, all income, and all expenses. It supervises management, if any, or any other personnel in these activities and reports on these activities to the board.

In summary, the board of directors run the association on behalf of its members. The officers conduct certain activities and functions at the direction of and on behalf of the board and report to the board. Board members have fiduciary duties to the association which cannot be avoided. The board members must always act in a manor that is in the best interest of the association. The board members cannot do anything which would interfere with the ability of the association to perform its function. Each board member must perform their functions and duties as a board member with undivided loyalty and a reasonable, prudent, and business like fashion.

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| ■ Contract Preparation and Enforcement | ■ Real Estate Sales and Closings |
| ■ Condominium Property Act - Explanation/Application | ■ Real Estate Tax Reduction for all units/properties |
| ■ Common Interest Community Association Act
Explanation/Application | |

by James A. Slowikowski, Esq. - Dickler, Kahn, Slowikowski & Zavell, Ltd.

Understanding “Being a Fiduciary”

If you are a board member, you have probably heard that you are a “fiduciary” or that you have a “fiduciary duty” to the association and the owners. But what does that mean?

What Is a Fiduciary Duty?

A fiduciary is a person who sits in a special position of trust and confidence with another person or an entity. The fiduciary is held to a higher standard to act in the best interest of that person or entity at all times. In the corporate setting, the directors and officers have a duty of loyalty to act solely in the best interests of the corporation. A director is required 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.

The directors and officers of condominium and community associations sit in such a position of trust. The board members are entrusted to manage and operate the affairs of the association

on behalf of all the owners. The board is in control of the funds and makes all financial decisions. Homeowners have made significant investments by purchasing a unit. The directors, who are solely in charge, are entrusted to properly care for that property and the finances.

The duty of loyalty requires the board members to act in the best interests of the association. The board member cannot put his or her own interests above the needs of the association. Illinois courts have stated that the fiduciary duty owed by the board of an association requires the board members to act in a manner reasonably related to the exercise of that duty and the failure to do so results in liability for not just the association, but

also the board and the individual board members.

The Business Judgment Rule

So, how do board members fulfill their fiduciary duty? There is a principle of law called the “business judgment rule,” which protects directors from liability for honest mistakes in judgment. A court will not find a board of directors in breach of their fiduciary duty if they have exercised reasonable business judgment when acting in good faith. This does not apply where there is bad faith, fraud, illegality or gross overreaching.

To have such protection, the directors must exercise “due care” in carrying out their duties. The exercise of due care includes “becoming sufficiently informed to make an independent business decision.” This means that directors need to exercise diligence to gather information before making decisions. This information may come from many

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sources, including personal observation and business records. Information often comes from professionals, such as property managers, attorneys, accountants, engineers, and contractors. While directors often have discretion to make decisions, those decisions should be made after gathering information. Directors cannot ignore facts that are available to them before making decisions.

How Do Directors Exercise "Due Care"

There are many ways directors can exercise due care. Most importantly, the directors must perform the duties that are imposed upon them by the association's declaration and bylaws, and by state and federal laws. Some of these duties may seem obvious. For instance, every board must assess and collect assessments, and adopt budgets which fix the amount of assessments. The board must collect those assessments

In connection with performing those required duties, each director must do what is best for the association even though the director knows it may negatively impact themselves or some owners. An example of this is increasing the amount of assessments or adopting special assessments. A board member who is unemployed or may feel that he or she cannot afford to pay higher assess-

ments must still adopt a budget increasing assessments, or adopt a special assessment, if the funds are needed by the association to perform the necessary work. It may be in the owner's best interest to have lower assessments, but that may not be in the best interest of the association.

Almost every board has a duty to maintain, repair, and replace portions of the property. The failure or refusal to do these things could be a breach of duty depending on the circumstances. An example of a situation where an association board was found by a court to have breached its duties as a result of failing to maintain the property involved a condominium where an elderly resident had water leaks into her unit over a long period of time. The evidence presented showed that the board was aware of the leaks but did not take any action to repair the building for many months, even after an engineer's report was provided. The court found the association breached its fiduciary duty and the association was ordered to pay punitive damages to the homeowner.

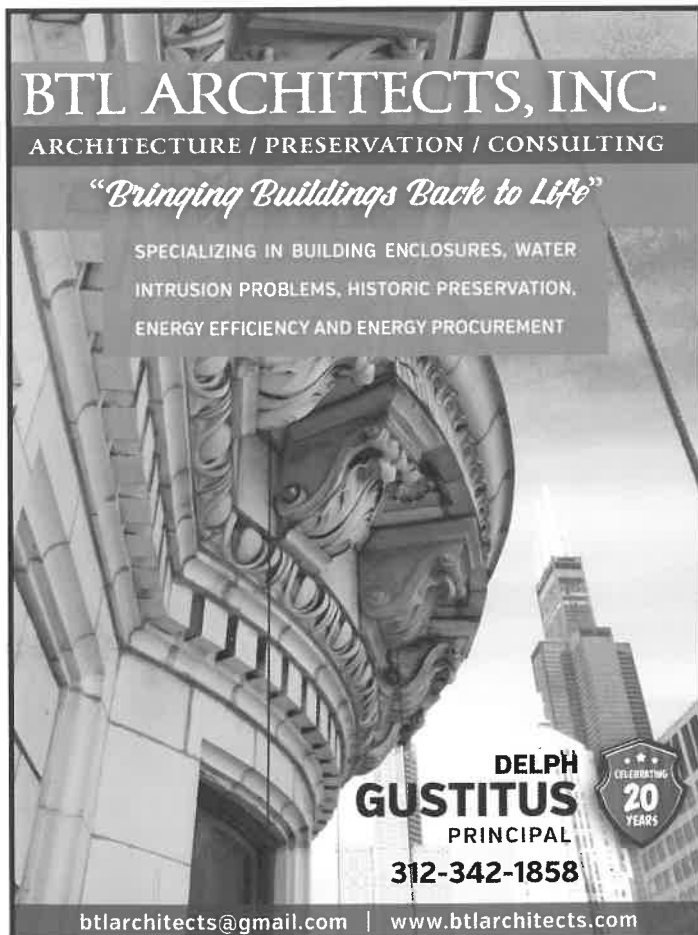
Another example where a court found that the business judgment rule would not protect a board involved claims that the board failed to obtain required insurance to protect association funds,

failed to review monthly bank statements that would have revealed embezzlement, and failed to obtain advice of their counsel regarding insurance coverages or association finances. That is a situation where directors may have ignored available information and as a result didn't take proper action.

The board also has a duty to follow and enforce its covenants, restrictions, and rules and regulations. So, if leasing is prohibited, the directors have a duty to enforce the leasing restriction. They cannot simply look the other way.

The board must follow all procedures required in the governing documents and the law, including procedures for meetings, elections, budgets, and providing proper notice of meetings. For example, in another court case it was ruled that a board breached its fiduciary duties by not providing notice of meetings as required in the bylaws, and by transferring funds between accounts in a manner which was inconsistent with the provisions of that declaration. Those breaches were the result of not following the declaration and bylaws.

Another court case found the board members to have breached their fiduciary duty where the board exercised a right of first refusal to prevent a



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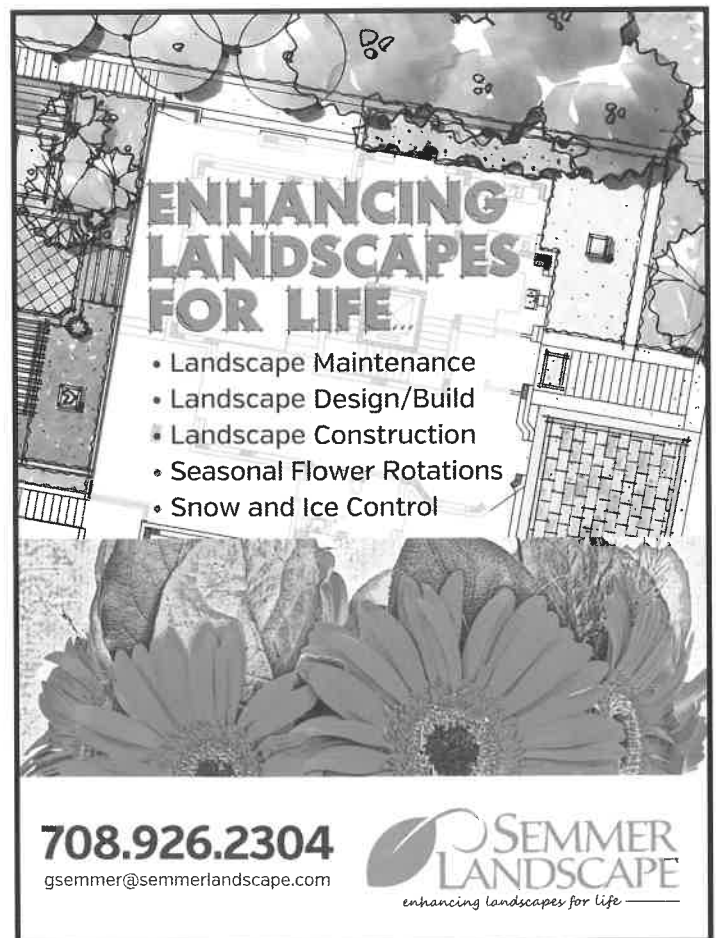
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resident from purchasing a unit. One of the problems was that the board did not properly follow the declaration procedures to exercise that right.

An example where directors may breach their fiduciary duty by failing to comply with the law is by failing to allow a reasonable accommodation or modification requested by a resident with a disability.

On the brighter side, other cases have shown how directors were not in breach of the fiduciary duty where they exercised due care by first informing themselves - even where the board decision turned out to be wrong. In one case, a board incorrectly allowed an owner to extend his balcony into the common elements. Even though the board was wrong and the extension was not allowed, the court found that the directors did not breach their fiduciary duty because they sought and obtained a legal advice from their attorney before making that decision. The directors informed themselves before making

The board member cannot put his or her own interests above the needs of the association. Illinois courts have stated that the fiduciary duty owed by the board of an association requires the board members to act in a manner reasonably related to the exercise of that duty and the failure to do so results in liability for not just the association, but also the board and the individual board members.

their determination.

Similarly, another court found that a condo board did not breach a fiduciary duty where it sought and obtained an opinion from its attorney regarding responsibility to repair and replace limited common elements. Again, the board first informed itself with professional advice.

Other professionals may provide advice which the board may rely upon. For instance, engineers and architects may advise the board if and when repairs or replacements are needed.

Consequences of a Breach

A breach of duty by directors will likely expose their association to liability. Also, a director who breaches a fiduciary duty may be found personally liable to the persons, and even the association, that suffered a loss as a result of the breach. Depending on the circumstances, directors and officers' liability insurance may not cover such liability, particularly if the actions were determined to be in bad faith or willful. The provisions in the declaration or bylaws that are intended to protect the direc-

tors from liability may not apply if the acts or the failure to act were in bad faith, grossly negligent, or fraudulent. In those situations, the director may be personally responsible for any judgment awarded. These are compelling reasons to properly fulfill the fiduciary duty by exercising due care and putting the association's needs first. ■



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