

SEVEN CRITICAL STEPS TO LIMITING THE LIABILITY OF THE BOARD OF DIRECTORS AND OFFICERS OF COMMUNITY ASSOCIATIONS

by Michael Schulman, Esq., - Wolf, Rifkin, Shapiro, Schulman & Rabkin, LLP

At times, newly elected Board members do not understand their responsibilities as Directors nor their liability should improper actions be taken while trying to learn their roles in a Nevada Non-Profit Corporation. Owners, committee members and tenants also have critical responsibilities to the Association, which is a subject in itself.

We are listing below seven critical steps that the members of the Board can take to limit their liability along with that of the Officers.

I. ACT WITHIN THE AUTHORITY GRANTED BY THE GOVERNING DOCUMENTS AND THE RELEVANT STATUTES.

- A. Board Members and Officers must act within the authority granted to them.
- B. Board Members and Officers will be judged by the Business Judgment Rule (Nevada Revised Statute Section 116.31036).
- C. Changing Standard of the Law in Nevada and/or other states (Business Judgment Rule versus Reasonableness Standard).

II. AVOID ALL CONFLICTS OF INTEREST

- A. Disclose all conflicts of interest (including any interest in vendors or other entities with whom the Association is dealing). NRS 116. 31034 requires that an person wishing his or her name to be placed on the ballot must make a good faith effort to disclose any financial, business, professional or personal relationship or interest that would result or would appear to a reasonable person to result in a potential conflict of interest for the candidate.
- B. Recuse oneself from participating in any vote where the member has a conflict of interest.
- C. Do not accept remuneration for serving on the Board of Directors (accepting such remuneration might affect the liability of the association or the personal liability of the Board member or officer/how accepting remuneration might affect the applicability of the association's officers and directors liability insurance).

III. ATTEND BOARD MEETINGS

- A. Regular meetings of the Board are normally scheduled at least quarterly. All Board members should attend as many meetings as possible.

B. Special meetings of the Board are set to handle certain issues. (All members should attend or participate by phone if possible.)

IV. STAY INFORMED/DUTY TO INVESTIGATE/DUTY TO DISCLOSE

A. Board members must stay informed of the issues at the Association by walking the property, talking to members, talking to the manager and participating in meetings.

B. Members of the Board of Directors should investigate when issues arise including, but no limited to, problems raised by members, ongoing maintenance problems which may be due to the failure to maintain or construction defects, or visible construction defects.

C. Review the reserves and the financial statements of the association on a regular basis (to keep informed regarding the need to increase reserves and/or to avoid any and all issues relating to fraud in the financial management of the association). Nevada law requires special review of the statements and the reconciliation's on a quarterly basis by the Board of Directors.

D. Keep apprized of new legislation, such as proposed amendments to NRS 116, especially affecting duties with respect to reserves.

E. Review all of the association's insurance in a timely fashion with or without the aid of the association's insurance agent and/or counsel to ensure that the association has the insurance that is required by the CC&R's and insurance which the experts believe is appropriate. Also, carefully review the director and officer liability insurance of the association to ensure that it covers the association as broadly as possible. Some directors and officers liability insurance has language which arguably might not cover persons who are appointed as directors to fill vacancies or persons who continue to serve after the term for which they were elected because no quorum was obtained at the annual meeting of the owners.

F. Obtain a copy of the insurance maintained by the manager and any vendor providing services to the association. Many contracts with vendors, specifically contractors, require the delivery of insurance policies and that the association be named as an additional insured. Often, the board is diligent enough to ensure that the correct language is included in the contract with the contractor. However, often the contract is signed without copies of the insurance policies being provided at the time of execution or at all.

G. If you are managed by a professional management company, ensure that the management company has a fidelity bond and that the fidelity bond names the association as an additional insured, so that if any employees of the management company steal funds from the association the bond will cover such theft. Normally, a fidelity bond will only cover theft of the funds of the insured (the management company) by its own employees.

H. Respond in a timely fashion to requests for documents and disclosures in the sale of units. Remember the Board's duty is to disclose to the present owner/seller not to the

buyer, the escrow company or the buyer's lender. The owner/seller must decide what to disclose. (Many times this is difficult because the escrow company or prospective lender demands disclosure from the management company.)

V. DO NOT PROCRASTINATE (DO NOT BECOME AN OSTRICH WITH YOUR HEAD IN THE SAND).

- A. Deal with the issues presented to the Board in a timely fashion.
- B. When necessary, hire professionals such as contractors, accountants, management firms, or attorneys to provide advice in a timely fashion.
- C. Do not avoid dealing with problems raised by owners in a timely fashion. Listen to the issues, make a decision, and disseminate the decision.

VI. ENSURE A RECORD OF ALL VOTES

- A. If there is a vote, make sure that vote is on the record and reflected in the Minutes.
- B. If a Board member disagrees with an action and votes against such action, such Board member should ensure that that vote is recorded in the minutes. If such vote is not recorded in the minutes, ensure that you as the dissenting Board member send a letter to the Board evidencing how you voted on the matter within 24 to 48 hours after the vote.
- C. Ensure that minutes are taken at all meetings of the Board of Directors, including executive session meetings, and that such minutes are kept in a safe place by the association and are provided to the homeowners where required by law (i.e. the minutes of the open meetings).

VII. MAKE A RECORD WITH RESPECT TO ALL ISSUES

- A. If an issue arises at a Board meeting and the Board has sought and obtained the opinion of counsel, have the opinion of counsel attached as an exhibit to the minutes. If it is an attorney-client privilege issue, have the attorney's opinion attached to the minutes of the executive session in which it was discussed.
- B. Similarly, have any and all expert's reports attached to minutes where they were discussed.
- C. Understand that substantially all claims that will be made against an association are usually made years after the incident triggering the event that occurs. Therefore, setting a record and including the experts' advice will help provide the Board and the officers the safe harbor of the business judgment rule.