



The "F" Word

UNDERSTANDING FIDUCIARY DUTY IN COMMUNITY ASSOCIATIONS

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You hear it all the time at condominium and homeowners association meetings:

"Boards members are fiduciaries ..."

"Board members have a fiduciary duty to the owners ..."

"Because that implicates your fiduciary duty, you should consult with the association's attorney ..."

But what does the "F" word – fiduciary – really mean in community associations?

Let's start with the word itself. Meriam-Webster defines fiduciary in two ways: (1) as an *adjective* – "of, relating to, or involving a confidence or trust"; and (2) as a *noun* – "one that holds a fiduciary relation or acts in a fiduciary capacity." Since we were always taught not to use the word you are trying to define in the actual definition, Meriam-Webster continues:

Fiduciary relationships often concern money, but the word *fiduciary* does not, in and of itself, suggest financial matters. Rather, *fiduciary* applies to any situation in which one person justifiably places confidence and trust in someone else and seeks that person's help or advice in some matter. The attorney-client relationship is a fiduciary one, for example, because the client trusts the attorney to act in the best interest of the client at all times. *Fiduciary* can also be

used as a noun for the person who acts in a fiduciary capacity[.] The words are all faithful to their origin: Latin *fidere*, which means "to trust."¹

Now that we have that basic understanding, let's discuss the basic corporate structure and how that relates to community associations. Generally, a certificate of incorporation and by-laws of a corporation constitute a contract between the corporation and its members. Directors or trustees² of a corporation are considered to have a fiduciary relationship with both the corporation and its shareholders/members³. As such, the directors' fiduciary relationship to those members requires adherence and compliance with the governing documents. These same tenets also apply to community associations.

An association's governing documents constitute a contract between the corporation (the association) and its members. An association's board of directors has a fiduciary obligation to both the association itself as well as to the unit owners/members⁴.

That means that the directors must act in good faith and to promote the health, safety, and welfare of the entire community. Decisions must be made for the protection of the whole association and each of the association's members, and not in an arbitrary or discriminatory fashion or for the benefit of any particular director⁵.

In Pennsylvania, these requirements are codified by statute⁶. By way of example, Section 3303(a) of the Uniform Condominium Act ("UCA") provides in part that:

the executive board may act in all instances on behalf of the association. In the performance of their duties, the officers and members of the executive board shall stand in a fiduciary relation to the association and shall perform their duties ... in good faith in a manner they reasonably believe to be in the best interests of the association

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and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances.

While no such statutory authority exists in New Jersey, similar requirements to those in the UCA have been long been required by case law as far back as the 1970s⁷.

Now that we understand the basics of being a fiduciary in a community association, how do we determine whether an association's board is acting in accordance with its fiduciary duty? Again, we turn to a long history of case law to help guide our inquiry.

Both New Jersey and Pennsylvania have adopted the business judgment rule to determine whether a community association is acting in accordance with its fiduciary duty⁸. The business judgment rule requires a two-pronged analysis. First, was the association's action (or inaction) authorized by law and/or the governing documents? If the answer to that question is yes, the second prong addresses whether the action or inaction was in any way "fraudulent, self-dealing, or unconscionable." As long as the association's board has the requisite authority to act and the action or inaction was both reasonable and done in good faith, the Court will not substitute its own judgment for that of the board⁹.

By way of example, let's discuss a typical collection action where a board is pursuing an owner for past due common expense assessments. In such action, the board requests both late fees and attorneys' fees from the delinquent owner. In her defense, the owner asserts that the board's actions are unreasonable and it has breached its fiduciary duty in trying to collect those additional fees from her. Utilizing the business judgment rule, we first look to whether the board's actions are

authorized by statute and/or the association's governing documents.

In this hypothetical, both late fees and reasonable attorneys' fees are authorized both by statute and the association's governing documents. Since the first prong is satisfied, we move to whether the board's action was in any way fraudulent, self-dealing, or unconscionable. Assuming that late fees and attorneys' fees are reasonable and the board is acting in good faith and not pursuing this owner based on some particular animus or discriminatory factor, there has been no breach of the board's fiduciary duty.

One more issue deserves discussion, and that is the fiduciary duty of a developer-controlled association. The seminal case on this issue comes from a small townhome development in Alameda, California. In that case, the developer-controlled board failed to adequately fund the association's reserves. In fact, no reserve account had been created and the owners were required to considerably raise their monthly assessments when they took control of the association from the developer. Under these circumstances, the Court held that the developer-controlled board had a duty of undivided loyalty, which they breached by making decisions for the association that benefited their own interests at the expense of the association and its members. And since the developer-controlled board failed in its obligation to establish a reserve fund and acted with a clear conflict of interest, the Court found the initial directors liable to the association for breach of their fiduciary duty¹⁰.

If you have made it this far, you have hopefully learned that being mindful of a board's fiduciary duty and questioning why decisions are being made is an important component of a well-functioning association. As always, if you have questions about whether your association's board is acting in accordance with its fiduciary duty, you should consult with your association counsel.

FOOTNOTES

¹ <https://www.merriam-webster.com/dictionary/fiduciary>

² Since the terms "directors" and "trustees" are equivalent for the purposes of this article, from hereon we will only use the term directors.

³ Fletcher Cyclopedia of Corporations (1975 Rev.), § 83 at 142.

⁴ *Thanasoulis vs. Winston Tower 200 Ass'n, Inc.*, 214 N.J. Super. 408, 420 (App. Div. 1986); *Siddons v. Cook*, 382 N.J. Super. 1, 7 (App. Div. 2005).

⁵ *Billig v. Buckingham Towers Condo.*, 287 N.J. Super. 551, 563 (App. Div. 1996).

⁶ Uniform Condominium Act, 68 Pa. Stat. § 3303; Uniform Planned Community Act, 68 Pa. Stat. § 5303.

⁷ *Papalexio v. Tower West Condo.*, 167 N.J. Super. 516, 527 (Ch. Div. 1979); *Thanasoulis, supra*, 214 N.J. Super. at 420.

⁸ *Thanasoulis, supra*, 214 N.J. Super. at 411; *Logan's Reserve Homeowners' Association v. McCabe*, 152 A.3d 1094 (Pa. Cmwlth. 2017) (citing *Cuker v. Mikalauskas*, 547 Pa. 600 (1997)).

⁹ *Thanasoulis, supra*, 214 N.J. Super. at 411.

¹⁰ *Raven's Cove Townhomes, Inc. v. Knuppe Dev. Co.*, 114 Cal.App.3d 783 (Cal. Ct. App. 1981).

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