

Condominium Boards and Ethics:

The top 5 reasons that your Association needs a Code of Conduct

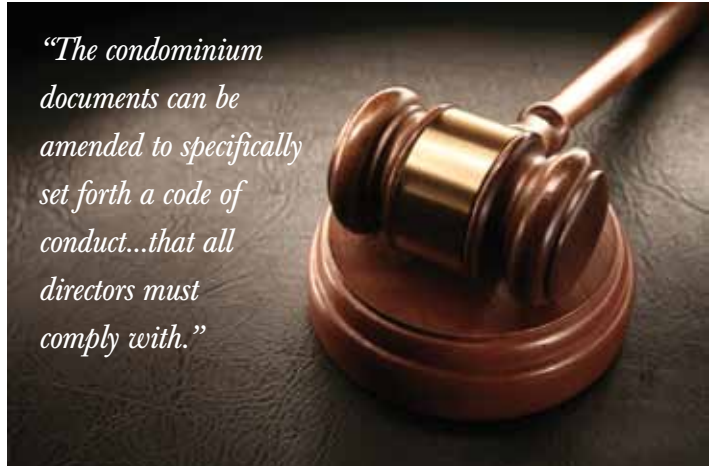
By Kevin M. Hirzel, Esq.

Condominium associations are largely governed by volunteer directors that receive little training with respect to their fiduciary duties and potential ethical issues that they may face. Each director has a fiduciary duty of care and duty of loyalty to act in the best interest of the association. Unfortunately, many directors blur the lines between what is in the best interest of the association and what is in the best interest of the individual director. The best way to prevent harm to the association by a self interested director is for an association to adopt a code of conduct. The condominium documents can be amended to specifically set forth a code of conduct or, at the very least, reference a code of conduct that all directors must comply with. Alternatively, the board of directors can typically use their rule making power to adopt rules and regulations to ensure that directors act in an ethical manner. Associations should be proactive in adopting a code of conduct so that all board members know what is expected of them by the co-owners and their fellow directors before problems arise. The top 5 reasons that a condominium association should adopt a code of conduct are to deal with the following issues:

1. Board Member Compensation

The Michigan Nonprofit Corporation Act, specifically, MCL 450.2546(3), allows for a board of directors to establish compensation for directors and officers of a nonprofit corporation as follows:

(3) The board, by affirmative vote of a majority of directors in office and irrespective of any personal interest of any of them, may



establish reasonable compensation of directors for services to the corporation as directors or officers, but approval of the shareholders or members is required if the articles of incorporation, bylaws, or other provisions of this act so provide.

Accordingly, the Michigan Nonprofit Corporation Act allows for directors to set their own compensation so long as the articles of incorporation, bylaws or other statutory provisions do not require shareholder approval. Accordingly, a board should review their

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bylaws prior to determining whether director compensation is allowed and under what circumstances. Most associations in Michigan do not allow for directors to be compensated. This is likely due to the fact that condominium associations simply do not have the budget to pay directors or that directors would like to maintain their status as “volunteer directors” under the Michigan Nonprofit Corporation Act in order to remain eligible for the liability protections that are not afforded to paid directors under MCL 450.2556.

In instances where director compensation is not allowed, issues often arise as to what constitutes “compensation.” While most directors understand they should not receive a salary, there are other gray areas that should be addressed through a code of conduct. By way of example, should board members be allowed reimbursement for mileage incurred with respect to board business? Are directors entitled to reimbursement for copying expenses? Most boards would likely deem the above items as acceptable reimbursements as opposed to “compensation.” In contrast, some boards may attempt to claim reimbursement for lost wages for time spent sitting in court or tending to other board business. Would reimbursement for lost wages be deemed compensation? What about accepting gifts or interest free loans from other owners or vendors? Most boards would likely deem payment for lost wages, gifts or interest free loans as unacceptable compensation. The adoption of a code of conduct provides directors with a clear understanding of what constitutes “compensation” and what constitutes acceptable reimbursement. Accordingly, it is best for an association to adopt a code of conduct before “compensation” issues arise.

2. Conflicts of Interest with Contracts and Vendors

Conflicts of interest often arise when directors are put into positions that allow for their own self interests to be put ahead of the best interest of the association. Conflicts of interest often occur when directors and/or their relatives act as contractors or vendors for the association. By way of example, if a director owns a landscaping company, should the landscaping company be allowed to provide landscaping services to the association? What if a relative of a director owns a property management company, should the board be allowed to hire that property management company?

In Michigan, the fact that a director may have a personal interest in a transaction that it enters into with the association does not necessarily mean that the transaction was improper. MCL 450.2545 provides as follows with respect to transactions between directors and nonprofit corporations:

A contract or other transaction between a corporation and 1 or more of its directors or officers, or between a corporation and a domestic or foreign corporation, domestic or foreign business corporation, firm, or association of any type or kind, in which 1 or more of its directors or officers are directors or officers, or are otherwise interested, is not void or voidable solely because of such common directorship, officership, or interest, or solely because such directors are present at the meeting of the board or committee thereof which authorizes or approves the contract or transaction, or solely because their votes are counted for such purpose if any of the following conditions is satisfied:

(a) The contract or other transaction is fair and reasonable to the corporation when it is authorized, approved, or ratified.



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(b) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or known to the board or committee, and the board or committee authorizes, approves, or ratifies the contract or transaction by a vote sufficient for the purpose without counting the vote of any common or interested director.

(c) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or known to the shareholders or members, and they authorize, approve or ratify the contract or transaction.

Accordingly, while the Michigan Nonprofit Corporation Act may allow interested director transactions in limited circumstances, many boards would like to avoid any appearance of impropriety altogether. The easiest way to prevent conflicts of interest is to ensure that directors are not put in positions where they are tempted to engage in self dealing. A code of conduct should specify whether interested directors are required to recuse themselves from voting on certain transactions. Similarly, a code of conduct should indicate whether transactions with interested directors will be prohibited altogether or whether they will be allowed in certain circumstances, assuming the requirements of MCL 450.2545 are satisfied.

3. Board Meetings

Board meetings provide a forum for disagreement when well intentioned board members do not see eye to eye on how to run an association. The utilization of Robert's Rules of Order, or some other form of parliamentary procedure, is essential to having differing opinions shared in a civil manner. All too often, boards will

not utilize Robert's Rules of Order, or some or some other form of parliamentary procedure, and board meetings end in screaming matches where little is accomplished. A typical code of conduct often indicates that Robert's Rules of Order, or some other form of parliamentary procedure will be used at board meetings. This not only ensures that board meetings will be run efficiently, but also requires directors to act in a professional, civil and respectful manner. Finally, and most importantly, the code of conduct typically requires all directors to respect the decisions of the majority of the board. All too often, directors that lose a vote attempt to undermine the board, which is often extremely detrimental to operating

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the association, but also makes it extremely difficult for directors to work together on future matters without conflict.

4. Bylaw Compliance/Assessment Payments

One of the most important responsibilities of a board of directors is to ensure that the members of the association are complying with the bylaws. However, enforcement of the bylaws can be especially difficult when a director violates the bylaws. By way of example, what happens if a director fails to pay assessments for an extended period of time? What about a director that installs a fence or deck in violation of the bylaws? While many condominium documents prohibit co-owners from voting at a meeting, or running for the board if they are in violation of the bylaws, very few condominium documents address situations in which the board member violates the bylaws after being elected to the board of directors. A code of conduct should ensure that all members of the board are current in paying their assessments, as well as complying with all of the other restrictions set forth in the bylaws. It is extremely difficult for a board to enforce the bylaws if one of the directors lives by the mantra “Do as I say, not as I do.” Accordingly, a code of conduct should also require a director to voluntarily resign in the event that a continued bylaw violation exists. While the condominium documents usually allow for the removal of the directors by a vote of the co-owners, this process is often difficult, and a code of conduct will provide another means of ensuring that each director is a model citizen.

5. Confidentiality

Most condominium documents do not contain a board confidentiality policy. In legal matters, the board of directors is responsible for maintaining confidentiality with respect to communications with counsel in order to preserve the attorney-client privilege. The decision to waive the attorney-client privilege should only be made by a majority of the board of directors. Adopting a confidentiality policy in a code of conduct is a good way to ensure that individual directors do not attempt to waive the attorney-client privilege by disclosing confidential communications with the association’s attorney. Similarly, individual board members have access to personal and financial information of the co-owners. A code of conduct ensures that individual board members do not disclose the personal and financial information of the co-owners. Accordingly, a code of conduct is important to ensure the directors have a clear understanding of what information they are to keep confidential.

Conclusion

The above list is a good starting point for a board to discuss with respect to formulating a code of conduct; however, it is not intended to be an exhaustive list of everything that should be included within a code of conduct. A board should consult with its attorney to analyze the existing bylaws and formulate a code of conduct that addresses the potential ethical dilemmas that directors may face. Associations should be proactive in adopting a code of conduct to prevent problems before they arise. The failure to adopt a code of conduct often leads to situations when the bylaws are selectively enforced, directors act in a self serving fashion, and the association is thrown into turmoil. Accordingly, the adoption of a code of conduct is a good way for an association to stay on the right track and avoid the cost and headache associated with litigating ethical quandaries. ■

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