

Dealing with Conflicts of Interest

by Jeffrey C. O'Brien, Mansfield Tanick & Cohen, P.A.



One of the most overlooked aspects of homeowners association governance is the fact that these associations are formed as non-profit corporations. As such, directors of the association are held to the standards established by the relevant statutory and case law regarding standards of conduct¹.

Association Directors' Fiduciary Duties

Members of the association's board of directors owe fiduciary duties to the association. These duties include a duty of care and a duty of loyalty. The duty of care requires each director to exercise the skill and care that a reasonable person would use under similar circumstances. The duty of loyalty requires the director to place loyalty to the association above other interests. A breach of this duty of loyalty constitutes a breach of fiduciary duty and can result in personal liability for the director.

What Constitutes a Conflict of Interest?

The duty of loyalty also requires the director to minimize potential and actual conflicts of interest. A conflict of interest is a situation in which an individual's duty to one leads to the disregard of a duty to another. The existence of a conflict of interest does not per se create personal liability for the director having the conflict. It is the failure to recognize and properly address the conflict where problems arise.

Conflicts of interest can be actual or potential. A potential conflict of interest occurs when an individual has interests that may conflict at some point. A potential conflict becomes an actual conflict of interest when the director having the conflict acts on the potential conflict.

Examples

Examples of conflicts of interest include the following:

- A director bidding on a contract with the association;

- Selective enforcement of the association's covenants (i.e., failure to enforce a covenants violation against a director or a friend of a director);
- The association board passing a budget which is insufficient to meet the association's expenses because the directors do not wish to increase their own association dues; and
- The association board approving the use of association funds for activities benefiting board members. For example, landscaping a common area near a director's home.

My own homeowners association has had to deal with a director's conflicts of interest. My tenure on the association board came to an end in October 2008 when I resigned in protest of what I saw as another board member's acting in disregard to clear conflicts of interest. I was also frustrated that the remaining directors refused to understand, acknowledge and deal with the wrongful actions.

In one instance, this board member (who happened to be a homebuilder) ordered a resident to take down a play set which the board later learned fully complied with our association's covenants. Upon further investigation, we learned that the board member was asked to have the play set removed by a neighboring resident who had hired the board member to build a deck. In other words, the board member pursued a course of action which was not in the best interest of our association in furtherance of his own financial interest.

Fortunately, my resignation caused our management company to intervene and advise the remaining board members about the conflict of interest and the need for procedures to deal with future conflicts.

¹The Minnesota Nonprofit Corporation Act has codified the pertinent standards of conduct for directors at Minn. Stat. §317A.251.

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The existence of the aforementioned conflict of interest does not mean that a board is prohibited from taking any or all of these actions. It does mean that the board must be careful to act in a manner which, at day's end, leads to an impartial and disinterested decision being made on a particular action. Following these steps will ensure that result:

- A director with a conflict of interest must disclose the conflict, provide all material information about the conflict to the board, and should abstain from deliberating or voting on the transaction at issue.
- With transactions or decisions benefiting board members, the board should document the factors it considered in making the decision, and when appropriate, seek help from professionals or third parties.
- If the conflict involves a board member bidding on a contract with the association, the board must engage in a competitive bidding process. If the board determines that the interested board member's contract proposal is the most favorable, then the board may approve the contract.

Meeting minutes should reflect any abstention by an interested board member.

The Importance of a Conflict of Interest Policy

Most non-profit corporation boards adopt a written conflict of interest policy. Such a policy defines situations in which a conflict of interest might arise and the process which the board is to follow in the event such conflict arises. Adoption of such a policy aids in the establishment of a consistent, uniform procedure for dealing with conflicts of interest.

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CIC Midwest Calendar

For more calendar information, go to www.CICMidwest.com or www.mmha.com

MHA Golf Classic

Thursday, August 13

Majestic Oaks Golf Club, Ham Lake

Two 18-hole courses, plus the Executive "Fun" Course, (you go around the course twice.) Lunch, Dinner, Goodie Bags, Raffle Prizes, 19th Hole Party, and fun in the sun! Go to www.mmha.com and click on the links for the golfer invitation and the sponsorship form.

Membership Happy Hour Social

Thursday, July 16th, 4:00-5:30 p.m.

Major's, 8301 Normandale Blvd.

Bloomington (494 & Normandale, go south)

Stop by Major's to catch up with old friends and meet new ones. It's also the end of the "What Are Your Chances" Membership Recruiting Contest. Recruiters get one or many chances to pick a masked prize from a big board. You could get cash, a prize, a booby prize or a joke! What are your chances? You won't know unless you're there to pick a square and find out what's behind it. The person who brings in the highest amount of new dues wins

The Grand Prize: A Weekend Getaway for Two at the Breezy Point Resort sponsored by Real Estate Equities; Fantastic Floors; RHR Information Services; Renovation Systems; Creative Landscapes by Pro-Wall; and MHA.

We look forward to seeing you there! RSVP to Angie.McKinley@mmha.com or call 952-854-8500.

CIC Midwest Lunch & Learn

Wednesday, September 30th

Budgeting for Operations and Reserves in a Challenging Economy

Presenters: **Scott Callahan**, Casey, Menden, Faust & Nelson, P.A., and **Paul Roth**, New Concepts Management. Dealing with association finances during challenging times takes persistence, hard work and change. How can you follow the budgeting and reserve basics when circumstances say it can't be done? Where are others cutting or finding new sources of income? What tips, new ideas, and new arrangements can be made as you draw up your annual budgets? Learn from two seasoned professionals how they see their associations managing their finances in a down economy.

Time: 10:30 - 11:15 a.m. Pre-Meeting Managers' Roundtable Discussion, everyone is welcome. 11:30 a.m. - 1:30 p.m. Presentation.

LOCATION: Holiday Inn, 1201 W. 94th St., Bloomington, 55431

Sponsors: Asphalt Associates; Breiwick Companies; CommonBond Communities; Cities Management; and ServiceMaster Cleaning & Restoration

Cost: \$29 members; \$39 non-members, includes lunch. \$50 for Registrations made after 12 noon the day before the meeting. Please make checks payable to MHA. **Register** by calling 952-548-2215 or email carrie.larson@mmha.com; or print out the online flyer/form at www.cicmidwest.com or www.mmha.com.

1.5 Continuing Real Estate Credits requested;
1.5 CCAM credits

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Management's Role in Minimizing Director Conflicts of Interest

Conflicts of interest are subtle, and dealing with them in the homeowners association context can be difficult. The management company who understands how to recognize and deal with conflicts of interest can be a tremendous asset to a homeowners association. If you are a manager working with an association that lacks a written conflict of interest policy, adoption of such a policy should be at the top of the agenda for the next board meeting for every association which you manage. ■

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