

Board Conflicts of Interest

When board members find themselves faced with a conflict of interest, it can derail an entire association—that’s why it’s so important for board members to nip these types of problems in the bud before trouble begins.

A conflict of interest is a situation in which an individual’s duty to one entity leads to the disregard of a duty to another. It is the duty of board members to recognize and deal with conflicts of interest as soon as they arise because directors are entrusted with the care, protection and/or the use of another person’s property.

The director’s duty encompasses both a *duty of care* and a *duty of loyalty*. The duty of care requires the director to exercise the skill and care that a reasonable person would use under similar circumstances. The duty of loyalty requires directors to place loyalty to the association above other interests, especially their own.

The duty of loyalty also requires the director to minimize potential and actual conflicts of interest. A breach of this duty of loyalty constitutes a breach of fiduciary duty and can result in personal liability for the director.

Discretion is an important facet of the duty of loyalty. As a fiduciary, board members can’t disclose information gathered in the course of duty.

For example, a person who serves as a director for both the developer and the association may be aware that water pipes used during development are substandard. To meet the duty of loyalty to the association, the director should disclose such information. However, to do so would result in a breach of confidentiality and loyalty to the developer. This director has a duty to separate entities and, thus, faces a conflict of interest.

To address such situations, directors must anticipate potential conflicts. They should ask the following questions when making decisions on behalf of the association, when deciding whether or not to serve on the board and when they are considering association transactions:

- Do I have any outside interests that may influence the decisions I make for the association?
- Do I have any outside interests that should be disclosed to the association regarding my role as a board member or a particular transaction?
- Do I have any duty to another entity that may influence my decisions as a board member?
- Do I have any duty to another entity that conflicts with the duty I owe the association?

In evaluating the first two questions, directors should consider their personal interests and their relationship with third parties—such as a spouse, child or business associate—that may affect their ability to be impartial. Directors should evaluate their relationship to other parties as well.

If the answer to any of the above questions is “yes,” the director should disclose to the board that he or she has an interest in a specific action, provide information about the potential conflict, refrain from the board discussion or decision-making process and abstain from the vote.

While liability insurance and indemnification provisions in association legal documents offer some protection, it’s vital that boards identify conflicts of interest and deal with them as they arise.

In fact, even before conflicts arise, boards should consult the governing documents for guidance and adopt a formal conflict of interest policy.