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NO GOOD DEED GOES UNPUNISHED

Minimizing Trustee Liability Protects Associations And Individuals

Indemnification Clauses Protecting Developers May Be Voided Altogether

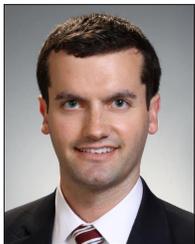
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SPECIAL TO BANKER & TRADESMAN

It is no secret that serving as a trustee on a board of a condominium association is a thankless job – and those who do choose to serve often assume that they are protected against personal liability.



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However, a recent Superior Court case, which held that an indemnification clause was void in the interest of public policy, raises concerns about protecting trustees against personal liability. Although the outcome in that case was sensible because the initial trustee, who was seeking protection under the indemnity provision, was the developer that breached its fiduciary duty, the decision makes clear



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the importance of carefully drafting condominium documents and implementing other protections for trustees in order to avoid personal liability.

Although condominium documents generally provide extensive protections for trustees against personal liability claims, courts do not always uphold these protections in the interest of public policy, such as when a trustee's interests are in direct conflict with his or her own interests. In *Board of Trustees of the Gates of Greenwood Home Owners' Trust v. Gates of Greenwood LLC*, the condominium developer formed the condominium and drafted the condominium documents, including a declaration of trust. The declaration of trust contained fairly typical language indemnifying the trustees from individual liability for their actions.

The developer oversaw the construction of the condominium and then sold units, at which time unit owners were appointed as trustees and the developer relinquished its role as trustee. The unit owners discovered construction defects and sued the developer for the alleged defects and for breach of its fiduciary duty to the unit owners by trans-

ferring the common areas and facilities in a deficient condition and by failing to remediate such defects. The defendant developer brought a third-party indemnification claim against the unit owners pursuant to the previously mentioned indemnification clause.

The court held that the indemnification clause was void as a matter of public policy, because the developer drafted the condominium documents while serving as the sole trustee and constructing the units. The developer's fiduciary duties to the unit owners conflicted with its own interests, and by inserting the indemnification clause, the developer attempted to insulate itself from all liability and make the trust and unit owners financially liable for its malfeasance.

Not The First Time

The court's recent decision in *Greenwood* was not novel. Another Superior Court case from 2000, *Harris v. McIntyre*, also found exculpatory clauses in condominium trusts void as violative of public policy where the developer drafted the condominium documents and served as the original trustee. Harris explicitly found that the trustee indemnification clause was only void as applied to the developer, whereas *Greenwood* did not expressly hold this. There does not appear to be any controlling precedent clarifying whether such indemnification clauses are altogether void or whether they are void only as applied to a developer serving as the original trustee.

Given this uncertainty, it is prudent to take actions to minimize the risk that such clauses are unenforceable, in order to encourage unit owners to become trustees without worrying about potential personal liability.

One way to accomplish this is to exclude from the indemnification protection the original trustee, if that trustee is the developer. The second way is to arrange for a third party to act as the original trustee, which would obviate the need for the exclusion.

Even if the condominium documents contain enforceable indemnification provisions, it is important that there be additional protections for trustees, including directors and officers insurance (D&O insurance). D&O insurance can ensure that the indemnification language in the condominium documents

actually protects the trustees. Indemnification is a worthless promise if the association lacks the funds to uphold it. If a trustee is named in a \$150,000 lawsuit and the association only has \$50,000 in its reserves, the indemnification provision is going to leave the trustee exposed.

Litigating the meaning of condominium document provisions or actions of trustees can be very expensive. Many unit owner trustees would not expect to have to pay these costs and would be ill-equipped to do so. However, D&O insurance will generally cover the defense costs for litigation.

Avoiding The Gray Areas

Another protection available to condominium trustees is found in established case law that defines a trustee's fiduciary duties. A trustee's obligation is to act in the best interests of the association, fulfilling duties of care and loyalty by putting the association's interests above his or her own. Decisions can be less advantageous than initially thought – or even wrong – but as long as they are not reckless, willfully negligent, criminal or outside the purview of a trustee's role, trustees generally will not incur personal liability for repercussions of their decisions.

As seen in the above cases, this protection is set aside where a trustee acted with his own best interests in mind, rather than with those of the association. Therefore, it is crucial for a trustee not to approach the danger zone of a conflict between his or her own personal interests and those of the condominium association, as such could leave the trustee without the protections of an indemnification clause or D&O insurance.

Condominium associations require involved trustees who take their fiduciary duty seriously in order to be operated efficiently and successfully. Carefully drafting the condominium governance documents and procuring D&O insurance that will protect trustees from individual liability in the course of serving as trustees will help attract just those kinds of individuals. ■

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