



# The Co-op & Condo Learning Center

## Rights and Responsibilities of a Board Member

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# Introduction

“The cooperative or condominium association is a quasi-government: a little democratic sub-society of necessity. The proprietary lessees or condominium owners consent to be governed in certain respects, by the decisions of a board. Like a municipal government, such governing boards are responsible for running the day-to-day affairs of the cooperative and, to that end, often have broad powers in areas that range from financial decision-making to promulgating regulations regarding pets and parking spaces...”

*Bowers v. Riverview Tenants Corp.*

# What is a Fiduciary?

- Someone responsible for managing other people's money or property
  - Examples:
    - Executors and administrators of estates
    - Trustees of trusts
    - Guardians of minors and incompetents
    - Managing agents and other agents
- Fiduciaries must use **care, skill** and **diligence** and act in **good faith**
- Board members are fiduciaries
- **BCL Section 701** – the business of a corporation shall be managed under the direction of its board of directors [*applies equally to board of managers of a condominium*]
  - The job is to establish policy and direct officers, agents, and employees

# Care, Skill and Diligence

- **BCL Section 717** - the board member must act “in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances.”
  - “due care” / “reasonable care”
  - Make informed decisions based on reasonable diligence.
  - Review documents, ask questions, and consult experts when needed.
  - Attend meetings regularly and participate actively.
  - Know your limits, act within your authority
- Leterman v. Pink – A director is chargeable with knowledge of the general condition, progress and financial situation of a corporation. A director is presumed to know everything concerning corporate affairs that he/she might have learned by the exercise of reasonable care and diligence.
- You are not expected to be an expert in everything, but you are expected to seek advice from those who are knowledgeable, including committees and experts.

# Reliance on Others

## Know what you don't know and seek out informed advice:

- **BCL Section 717** (again) - a director shall be entitled to rely on information, opinions, reports or statements . . . in each case prepared or presented by:
  - (1) . . . officers or employees of the corporation . . . whom the director believes to be reliable and competent in the matters presented,
  - (2) counsel, public accountants, consultants or other persons as to matters which the director believes to be within such person's professional or expert competence, or
  - (3) a committee of the board upon which he does not serve, duly designated in accordance with a provision of the certificate of incorporation or the by-laws, as to matters within its designated authority, which committee the director believes to merit confidence
- **BCL Section 712** – If the By-laws or Certificate of Incorporation allows, the board may designate from among its members a committee, consisting of directors, which has the authority of the board, with certain limitations (e.g. amending the by-laws, filing a board position, etc.) recommendations).
  - Directors as committee members have the same duties they have as directors

# Good Faith

- What does it mean to act “in good faith?”
  - Directors must act with “undivided loyalty to the corporation”
  - Place the building’s interests above your own
  - Avoid self-dealing, nepotism, and undisclosed conflicts of interest
  - Disclose and recuse where conflicts exist
  - You don’t get to put the decision on the shareholders/unit owners except in limited cases
  - You can’t advance your own interests at the expense of the organization’s interests
- Brecher v. Greg – Directors are bound by all those rules of conscientious fairness, morality and honesty in purpose, which the law imposes as guides for those who are under the fiduciary obligations and responsibility, and they are held, in official action, to the extreme measure of candor, unselfishness, and good faith.
- **BCL Section 713 – Interested Directors**
  - No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any other . . . have a substantial financial interest, shall be either void or voidable for this reason alone . . . [i]f the material facts as to such director’s . . . interest are disclosed in good faith or known to the board . . . and the board . . . approves such contract or transaction by a vote sufficient for such purpose without counting the vote of such interested director or, if the votes of the disinterested directors are insufficient to . . . by unanimous vote of the disinterested directors

# Directors Can Be Held Liable for Breach of Duty

**BCL Section 720 - (a) An action may be brought against one or more directors or officers of a corporation . . . in the following cases:**

(A) The neglect of, or failure to perform, or other violation of his duties in the management and disposition of corporate assets committed to his charge.

(B) The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties.

**You are there to act for the organization, not yourself:**

- You are not entitled to monetary gain
- You are not entitled to special exceptions or permissions
- You are not entitled to divert corporate opportunities

# Decisions Holding Directors Liable

## A breach of duty has been found in the following:

- Nonattendance by directors at board meetings is not an excuse and does not prevent a director from liability for failing to meet their duties of care and diligence.
- Directors are expected to become familiar with the general business of the corporation and the business of the corporation itself. They can delegate others to execute the corporate policies of the Board, and they are not insurers of the conduct of those designated. However, they are liable for losses that result from the failure to exercise due care in appointing such people, and for failure to supervise their activities.
- Acquiescence in bad or inept management by inaction when action was required (one case involved lack of competitive bids).
- When the directors have acted in a wantonly negligent and reckless manner.
- Using a board seat for personal gain.

# Good Faith Directors Are Protected

## **BCL Section 722 – Indemnity**

- A corporation may indemnify any person who is sued by reason of the fact that he was a director or officer of the corporation, if such director or officer acted, in good faith, for a purpose which he reasonably believed to be in the best interests of the corporation.

## **BCL Section 726 – Insurance**

- (a) A corporation shall have power to purchase and maintain insurance to indemnify directors and officers in instances in which they may be indemnified by the corporation under the provisions of this Article.
- (b) No insurance under paragraph (a) may provide for any payment, other than cost of defense, to or on behalf of any director or officer:

(1) if a court determines that his acts of active and deliberate dishonesty were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled

## **BCL Section 402 – Exculpation**

- The certificate of incorporation may set forth a provision eliminating or limiting the personal liability of directors to the corporation or its shareholders for damages for any breach of duty in such capacity, provided that no such provision shall eliminate or limit the liability of any director if a court determines that his acts or omissions were in bad faith, involved intentional misconduct, were a knowing violation of law, or that he personally gained a financial profit or other advantage to which he was not legally entitled

# Business Judgment Rule

**Board decisions will not be second guessed by the courts, and will stand, when made in the proper exercise of the Board's business judgment.**

- ***Levandusky*** held that discretionary board actions are subject to such deference by the courts unless it can be shown that the board acted in bad faith, outside of its authority, or not in furtherance of the corporation's legitimate interests.
- The shareholder complaining must prove that the Board failed one of these tests. The decision does not have to be "reasonable" or even "correct", as long as it meets the three-prong test. Board should be able to show it followed the advice of its professionals.
  - If the Board acts recklessly or in wanton disregard to the facts, it may be held that they did not act in good faith.
  - Does not apply if there is a breach of contract by the Board or when the Board is required to be reasonable (ex. consent to an alteration).

# Recommendations To Protect Directors

- Know your Organizational Documents
  - Co-op:
    - By-laws: Defines the shareholders' rights and privileges
    - Proprietary Lease: Defines the shareholder's rights and privileges as a resident (i.e., tenant)
    - House Rules: Rules for living in the apartment
  - Condominium:
    - Declaration: Defines the Unit, Common Areas and Limited Common Elements (among other things)
    - By-laws: Defines rights and obligations as a resident as well as a Unit Owner
    - House Rules: Rules for living in the apartment
- Review (or create) Code of Ethics / Confidentiality Policy
  - Litigations
  - Personnel issues and staff performance
  - Financial or proprietary information (e.g., contract negotiations)
- Review or Create a Conflicts Policy
  - Avoid even the mere appearance of impropriety

# Recommendations (con't)

- Review management and financial reports
  - Review arrears and accounts payable
  - Review all paid bills
  - Review Buildings cash position and budget
- Handling the Finances
  - Establish responsibilities
- Be sure that policies are in writing, in the Board minutes and in compliance with the organizational documents.
- Be sure that Board decisions are consistent
- Establish procedures and responsibilities regarding interactions with professionals (management, accountants, attorneys, engineers, etc.)

# Save the Date

## Co-op & Condo Learning Center

- **March 24 – Pitfalls When Calling Annual, Special and Board Meetings**
  - Julie Schechter, Dale Degenshein, Peter Massa
- **May 5 – Financial Matters**
  - Andrew P. Brucker, Rob Mellina, Ed Howe
- **June 9 – Recent Laws You May Have Forgotten**
  - Ravi Sachania, Howard Schechter, Eric Wohl

# Thank you!



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