

Condominium Director's Liability: Conflicts of Interest and Self-Dealing

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On February 3, a federal jury in Tallahassee returned a verdict for the *Shores of Panama Resort Community Association* for \$11.9 million against four of its former directors. Of that amount, \$10 million was for punitive damages - damages not covered by insurance under Florida law. The directors had been elected to the association's board thanks to the votes of a group of investors who had acquired approximately half of the condominium units through a bulk sale transaction. The association claimed that the directors breached their fiduciary duty to the membership. They settled a lawsuit in which they deeded away valuable beach property owned by the association to the bulk buyer companies, while getting nothing in return other than the dismissal of the lawsuit. The directors all had financial interests and other connections to the bulk buyer companies. The evidence at trial indicated that they acted as mere proxies for those companies, signing off on various transfers of association assets that could not be justified. These transfers caused financial harm to the association. The jury responded accordingly.

The Shores of Panama verdict has sweeping implications for real estate investors who purchase condominium units in bulk, intending to use the voting strength of those units to acquire control of the association's board.

Such investors are now on notice that taking over control of an association carries substantial risks, if the intent is to use that control at the expense of the remainder of the association's membership. Conversely, the verdict sends a message of hope to condominium associations who have suffered at the hands of bulk unit purchasers who run the association for their own benefit. The message is clear: the director's fiduciary duty does not change because he happens to have been elected by a bulk buyer. Directors are expected to exercise independent judgment and act on behalf of all association members, not serve as proxies to the entities that vote them on to the board. Associations now know that they can fight back, and fight back hard, against directors who place the interests of themselves and their colleagues ahead of the membership. While this verdict is a stark reminder of the risks that attend the

job of condominium director, it should by no means frighten away well-intended people from serving on condominium boards. The facts of the Shores of Panama case were extreme, and involved a pattern of willful and flagrant disregard of the association's best interests by the directors involved. Well-meaning condominium members wishing to serve on their association's board are unlikely to encounter similar conditions. Still, there is no denying that a board member takes on a certain measure of liability by agreeing to serve. Nevertheless, by acting in good faith and observing a few common sense practices, any condominium director should be able to avoid the pitfalls of liability that the Shores of Panama directors fell into.

BEST PRACTICES

- Take time to learn about your association. What are its sources of income? What are its major expenses? What are the most pressing issues it faces? Directors cannot know everything about the association, but neither can they remain willfully ignorant of the most rudimentary facts and expect to be granted immunity from liability when things go wrong.
- When faced with a vote in which you have a possible conflict of interest, follow these three rules: (1) make a full disclosure of your interest; (2) abstain from voting on the matter; and (3) be certain the minutes reflect both the disclosure and the abstention. It would also be a good idea to keep a copy of the minutes for your personal file. It is not unheard of for association records to get lost, especially when an association changes management companies.
- Use common sense. It is not prohibited for an association to do business with a company owned by a board member, so long as there is full disclosure and the transaction is favorable to the association. Purchasing insurance through an agency owned by the treasurer's husband may be fine, so long as there was full disclosure and the premium was competitive. If the association could have obtained equivalent coverage for a fraction of what it paid to the husband's agency, the board is not properly protecting the membership's interests.
- When you sense the appearance of a conflict in connection with any ongoing matter, trust your instincts. Put yourself in the shoes of a member looking in from the outside and ask how your actions will appear to such an observer? How would you assess that same conduct if you were evaluating another director's actions? If you find you would have trouble explaining your stance to an outsider, it may be time to rethink your position.
- Don't let liability concerns overwhelm you to the point that those concerns drive every decision you make. Let reason and common sense be your guide, not fear of being sued for making a bad decision.

Condominiums cannot exist without good people willing to undertake the role of board member. The liability that accompanies board service can never be entirely eliminated, but a director can substantially mitigate that risk. By remembering whose interests you are expected to serve and encouraging complete transparency in all board decisions, you should easily be able to avoid

those perilous conflict of interest situations. And above all, remember that you must exercise independent judgment, not act as a proxy for some outside interest.
