

Fiduciary Fight

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By: **In Memoriam - John Cottle, (1952-2018)**

THE LATE-AUTUMN SUN hung low over the Gulf of Mexico. Looking south from the fourth floor breezeway of the Shores of Panama condominium tower, you could absorb the serenity of a North Florida sunset, inhale the cool, salt-charged air and understand the notion of timelessness.

But none of the 100-plus people inside a ballroom took note of the scene outside on Nov. 10, 2014. They were focused on the task at hand. Choices were being weighed in a board election that would determine the fate of this 23-story condominium resort.

Two-and-a-half years earlier, a group of bulk buyers purchased 345 of the condominium's 785 units. Thirty-seven of those units were nothing more than janitor closets and vending machine spaces, which the original developer had classified as commercial units that possessed the exact same voting strength as a three-bedroom residential unit. With those votes, the bulk buyers took over the association's seven-member board and installed four proxy directors with whom they shared financial ties and family connections. Later, the bulk buyers would gain control of the three remaining board seats.

Once in charge, the bulk buyers put their own interests ahead of the other owners and the community itself. They seized revenues from a beach vendor contract, amounting to over \$100,000 per year, even though the association owned the beach. They took possession of the front registration desk, even though the association owned the desk. They reduced assessments levied against their units. They also filed a lawsuit against the association, contending that the beach rightfully belonged to them.

At the 2014 election, with the bulk buyers still controlling 315 units, four of the seven board seats were up for grabs. Assuming no defections, about 80 percent of the community's other owners— an almost unheard of participation rate in associations—needed to cooperate to wrest control from the bulk buyers.

For two years, Dean Lautzenheiser and Denise Hinds had organized owners and spread the word about what the bulk buyer board members were doing to the association. As the votes were counted, they wondered whether they would

get enough support to regain control of their community.

TRYING TIMES

Trouble began at the Shores of Panama when the developer declared bankruptcy in 2008, followed by a failure of the developer's bank in 2009. As a result, the Federal Deposit Insurance Corporation ended up with the unsold units, a giant lagoon-styled pool and pool deck, and a beach. When the FDIC sold the units and lagoon pool to the bulk buyers in April 2012, it deeded the beach to the association.

Approximately a year later, the bulk buyers' attorney wrote the FDIC to assert that the closing attorney made a mistake, and the beach should have been included in the deal. The FDIC's in-house counsel wrote back immediately and advised, in no uncertain terms, that no mistake had been made. The FDIC never intended to deed the beach to the bulk buyers. Unfortunately, the attorneys' exchange was concealed from the other owners, and the bulk buyers pocketed revenues generated from the beach vendor contract.

Despite the FDIC letter, the bulk buyers sued the association for ownership of the beach. The association attorney advised the board president that the entire board, which was composed entirely of bulk buyer board members at the time, had a conflict of interest and that it should appoint a committee of disinterested owners to manage and defend the lawsuit. The board declined to follow the advice and sought other counsel instead, ultimately finding an attorney who said the lawsuit could be settled by giving the beach to the bulk buyers.

HOPE, DESPAIR, SUCCESS

When the 2014 election results were announced, the ballroom attendees erupted into cheers, handshakes and hugs. The bulk buyer candidates had been defeated.

Lautzenheiser assumed the presidency with Hinds as vice president. It didn't take them long to discover that just four days earlier, the bulk buyer board had gathered at a closed meeting and voted to settle the beach lawsuit. The terms required the association to deed the beach to the bulk buyers without any monetary consideration.

The new board moved fast, hiring a law firm to formulate a legal strategy to recover the beach and address the other wrongs committed by the bulk buyer board.

The board took over a pending lawsuit previously filed by an individual association member and amended the complaint to allege additional breach of fiduciary duty claims against four of the bulk buyer board members. Discovery in the case uncovered two critical documents: the FDIC letter to the bulk buyer's attorney that denied a mistake in deeding the beach to the association and a transcript of the closed meeting where the bulk buyer board voted to

settle the lawsuit. The documents would prove invaluable in the ensuing trial.

It was remarkable that someone decided to make a transcript of the closed board meeting. The transcript revealed a great deal about the bulk buyer board's desire to keep the beach lawsuit settlement confidential from the other owners. There was even a reference about the need to "keep it quiet" until after the board election was certified. Noticeably absent from the discussion was any meaningful debate about whether the settlement was in the best interests of the association. Faced with a transcript that showed no reflection or serious discussion about the terms of the settlement, the bulk buyer board members were boxed into an untenable position.

The four board members conceded nothing in the litigation, claiming that they relied on their counsel's advice to settle the beach lawsuit and that they, in good faith, believed that their actions had been in the association's best interests. Ultimately, the association was able to muster proof of how the bulk buyer board had abused the association's membership by taking from them—without paying a dime—a beach valued at almost \$1.3 million.

The Shores of Panama Resort Community Association v. Halberthal et al trial took place in early 2016 in federal court in Tallahassee. The association proved the details concerning the beach lawsuit, showed how it was settled without the knowledge of the association's membership, and established the financial and family connections between the four defendants and the bulk buyers. The trial resulted in a verdict for the association of almost \$12 million, including a total of \$10 million in punitive damages assessed against the four bulk buyer board members. The case is expected to be appealed.

"The Shores of Panama owners are ecstatic with the verdict," says Hindes. "We hope it discourages other developers and bulk buyers from breaching their fiduciary duty by abusing their positions on a board for financial gain."

Lautzenheiser echoed those sentiments, noting the herculean effort necessary to mobilize the other owners to action during the 2014 board election.

"An important success factor (for the election) was constant communication to the owners," he says. "Over two years, I sent out over 40 mass e-mails to the owners giving them updates—not only on the legal matters but also other information about issues at the resort. I believe this constant spread of information kept the owners interested and consolidated during the long ordeal."

REAL IMPLICATIONS

The verdict has national implications for both real estate investors and condominium associations under the control of bulk buyers and developers. For unscrupulous investors who take over an association and expect to plunder its assets, the verdict sends a stark reminder about fiduciary duty. Condominium

board members owe such a duty to the association they serve.

As a fiduciary, a board member is expected to place the interests of the association above his own, as well as above the interests of friends and colleagues. Board members with affiliations to bulk buyers are now on notice that self-dealing and playing fast and loose with association assets are subject to severe punishment in the form of punitive damages.

Both Lautzenheiser and Hindes believe Florida law needs to protect condominium owners from the actions of bulk buyers who overstep their bounds.

“The Florida legislature needs to make changes to state law so that a director would have to own, at minimum, a residential unit in the condominium they seek to represent,” says Lautzenheiser. “Storage closets and other small commercial units shouldn’t have the same voting power as a residential unit.”

Hindes adds that the number of board seats held by individuals affiliated with bulk buyers should be limited.

“It’s not in the average owner’s best interest for bulk buyers to retain a large voting bloc, which can lead to control of the board for a long period of time,” she says.

Associations under the control of a bulk buyer or developer should take hope from the Shores of Panama verdict. If a board is ignoring the best interests of the association and engaging in transactions riddled with self-dealing and conflicts of interest, it’s possible to organize and fight back. It may require massive organizational efforts and intense research—all coordinated by an experienced legal team—but the tools to retaliate against those who are harming the community are available.

A fiduciary cannot serve two masters. That duty is owed to the association and its owners, not to the companies that elect or appoint members to the board. Volunteering to serve in a fiduciary capacity is a serious undertaking, and the costs of taking that duty lightly can be harsh. Anyone who doesn’t understand the nature of the duty or appreciate the consequences of abusing that power would be well advised to stay far away from condominium board service. John Cottle is the managing shareholder of the Fort Walton Beach, Fla., office of Becker & Poliakoff. He was the attorney of record for the Shores of Panama Resort Community Association.

SELF-DEALING SIGNS

If you’re concerned your board is abusing its fiduciary duty, take note of the following:

Pay attention to connections among board members. Do any board members have business or family connections to each other and routinely vote

together on association business?

Examine the annual budgets. What goods and services account for the association's major expenses? Who are the vendors providing those goods and services? Do those vendors have connections to board members? Do any line items indicate debt repayment to unfamiliar companies?

Observe whether absentee board members ever come on the property. Attending meetings by telephone is fine, but have you ever seen board members on the property?

Monitor whether there are full and open discussions of association business at meetings. Do board members seem to be rubber-stamping every agenda item without any meaningful discussion? Are critical decisions being made in secret?

Study whether board members respect transparency. Are owners allowed to attend board meetings and ask questions? Are any of their answers evasive? Do they respond to records requests?