# The Shores of Panama Case: The Fiduciary Duty Owed By Bulk Buyer Controlled Boards

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The election had been fiercely contested, and everyone knew the vote would be close. The incumbent directors of the Shores of Panama Resort Community Association had the unwavering support of a group of investors who had, two and a half years earlier, purchased just less than half of the condominium units in bulk at a distressed-asset fire sale. With the voting strength of those units, the bulk buyers had elected their colleagues as directors and controlled the association's board for those two and a half years. During that time, they took numerous actions which owners not affiliated with the bulk buyers considered to be self-dealing and inimical to the association's interest. Now, however, the other owners were organized and fighting back with their own slate of candidates. When the final vote was counted and the results announced, the room erupted in cheers. The incumbent directors had been defeated, and the bulk buyers had lost control of the board. The celebration was short-lived, however, as the new board began assessing the damage of the past two and a half years. The first thing they discovered is that the association had just lost its $1.3 million beach.

Less than five months before the election, the bulk buyer companies had sued the association, claiming that when they purchased their units, they were supposed to have been deeded the beach. The seller, the lawsuit claimed, had made a mistake at closing by deeding the beach to the association rather than the bulk buyers. The lawsuit sought to correct this alleged mistake by forcing the association to give up the beach to the bulk buyers. Four days before the election, the bulk buyer board met in a meeting closed to other owners and voted to settle the lawsuit by deeding the beach to the bulk buyers for no monetary consideration. The only thing the association got from the settlement was the dismissal of the lawsuit. This settlement was kept confidential from the other owners until after the election. Remarkably, the bulk buyer board was actually able to find an attorney to bless this corrupt bargain and provide a written opinion designed to give cover to the directors.

The new board moved quickly to stop the bleeding. It filed a motion to set aside the settlement of the beach lawsuit, filed a separate lawsuit seeking to recover the beach, and assumed control of a lawsuit filed earlier by an individual association member accusing four members of the bulk buyer board of a breach of fiduciary duty. The association promptly amended that action by adding the beach lawsuit settlement to the parade of director misconduct. The directors responded by asserting that they had relied on advice of counsel in deciding to settle the beach lawsuit as they did. That defense fell on deaf ears. On February 3 of this year, a federal district court jury in Tallahassee returned a verdict for $11.9 million against the former directors, $10 million of that amount being in punitive damages. Pursuant to Florida law, there is no insurance coverage for the punitive damages.

The Shores of Panama verdict will unquestionably have a wide-ranging impact on real estate investors seeking to purchase distressed condominium assets in bulk. Any investor purchasing close to, or more than, half of the units of a failed condominium will typically expect to gain control of the association for at least a limited period of time. The reasons for seeking to control an association range from the innocent to the nefarious. Not every investor seeks power over an association in order to plunder its assets, à la the Shores of Panama, but virtually all will want some degree of control to facilitate the marketing and sale of their units. Regardless of reasons and motives, there is generally friction created between owners and investors when a bulk buyer or subsequent developer takes control of a condominium board using the voting strength of its newly acquired units.

In the wake of the Shores of Panama verdict, investors are now on notice that their exercise of board control carries substantial risks for their proxy board members, especially when they use that control to further their own interests at the expense of other association members. Even when the board can find an attorney willing to sign off on questionable practices, the directors will not necessarily be immune from liability. Advice of counsel, while a valid defense to claims against directors in most situations, will not afford protection where a legal opinion is sought and given solely to provide cover for questionable board decisions. In the Shores of Panama case, the four directors who approved the settlement of the beach lawsuit all had financial or family connections to the bulk buyers and their principals. As those directors learned, pleading advice of counsel as a justification for such obvious self-dealing will not generally impress a judge or jury. At the end of the day, directors installed by bulk buyers and subsequent developers have the same fiduciary duty to the membership as any other directors. Such directors would be well advised to remember who they are charged with serving, as well as the potential consequences of placing the interests of investors ahead of the association’s membership.

On the other side of the coin, associations may now take heart that they have a sizeable hammer available when a board subject to outside influences makes decisions that harm the membership. Once board control passes from the subsequent developer or bulk buyer to the other owners, the association will be

in a position to hold former directors accountable for shirking their fiduciary duty. Directors who violate their trust do so at their own peril, and would be well advised to remember the lessons of the Shores of Panama case.