MATTHEW D. SKIPPER
Managing Partner
JEFFREY A. KAHNTROFF
Partner
JEFFREY T. PHIPPS
Associate Attorney

SKIPPER LAW

2127 Espey Court, Suite 100
Crofton, MD 21114

410-919-2121
fax 410-919-2111

www.SkipperLawllc.com

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VIA EMAIL ONLY
Sara H. Arthur, Esq.
Arthur Law Group, LLC
2448 Holly Ave, Ste. 303
Annapolis, MD 21401

RE:	Concern relating to conflict of interests
My client:	Concert Woodmore, LLC
My file:	1153 – 23 M
Your client:	Pleasant Prospect Homeowners Association, Inc.

Sara:

I know we have spoken at length on several occasions about the disputes between our respective clients giving rise to the pending mediation with Judge Platt slated for November 10, 2023 and the potential arbitration with Judge Connelly scheduled for December 15, 2023. Like any mediation and the period leading up to mediation, I understand that we may discuss potential resolution of any or all claims that either of our clients would present at arbitration. The primary purpose of this letter is to protect everyone involved in any potential resolution, including ourselves as lawyers and our clients. A secondary purpose of this letter flows from my client's desire, as a neighboring landowner concerned about its own reputation, to set forth accurately the facts and circumstances that have the potential to again engulf the community and Country Club in costly dispute resolution.

The two current disputes that we have raised and are properly before us at mediation and arbitration are (1) the level-loading fee that my client implemented across all membership categories and (2) the gate card "access fee" of $50 per card per month plus activation fees that your client has advanced. While I recognize there are related tangential issues, the replacement of the 22% service fee with a fixed level-loading fee and gate card access fee are the two issues that currently will be arbitrated before Judge Connelly in December if the parties fail to resolve the matters.

In our call on October 12 I briefly asked you about the facts related to this issue. Namely, I expressed concern that both sides were spending substantial amounts of money on lawyers, mediation and arbitration for an issue that was, in my view, not financially justified. I will acknowledge that in my practice, I often represent homeowners that choose to spend their own money to fight for their property rights regardless of the economics of the case. But that's different. A homeowner has a right to fight for their own property rights and spend their own money. This current case is between two corporate entities. Here, your client – a homeowners' association – acts through its board of directors to make decisions for the community as a whole. The board and each individual director owe fiduciary duties to the homeowners in Woodmore. Those duties include the duty of care and duty of loyalty to the lot owners whom the law views as shareholders in the community.

Triggering of the Interested Director Rule and the *Kenney* Case

Applying those duties to a community association board of directors requires that any HOA board properly consider, navigate and potentially justify any decision that the board makes that triggers both the common law interested director rule and the statutory analog found at Md. Code Ann., Corp. & Ass'n Art. § 2-419. Application of the interested director rule begins of course with the question of whether the rule applies to a transaction or decision. That analysis in our dispute is fairly straightforward and is largely governed by the Appellate Court of Maryland's recent decision in *Cherington Condominium v. Kenney*, 254 Md. App. 261 (2022).

In a case of first impression, the intermediate appellate court applied the interested director rule to the community association context. I am familiar with *Kenney* both because it is binding precedent as a reported case, but also because it was my case. Heather Kenney represented herself at her hearing before the Montgomery County CCOC. Ms. Kenney lost the CCOC hearing, but hired me to handle her appeal. The appeal addressed, among other issues, her claim that the Board members (who were townhouse unit owners) had different interests than the community at a whole (which consisted of both townhomes and garden style units). The Circuit Court and Appellate Court of Maryland both ruled in her favor, holding that the interested director rule applied to the board's vote on an assessment matter that would benefit townhome owners but not garden-style owners. *Kenney* at 292.

This matter involves a dispute that benefits Woodmore HOA owners who are Country Club social members at the expense of others. Because five of the ten (10) HOA board members are social members, they are interested directors. Despite this large presence of social members on the board, only about 21% of the Woodmore community as a whole (measured by lots) were social members as of March 2023.

Application of the Interested Director Rule

In March 2023 the Woodmore Board chose to (1) retain your services and (2) pursue this issue directly with the Country Club. The Board was required to vote on that decision as you know. I realize that my client does not know the vote tally for that vote, nor the discussion that led to the vote. The ultimate result of that decision in early 2023 was your letter to my client dated 28 April 2023 that said:

> Please advise if the Country Club will rescind the fee for Woodmore residents. If not, please consider this letter notification under Section 12 of the Settlement Agreement that Woodmore Board wants to proceed with dispute resolution of this issue.

Letter from Sara Arthur to Peter Nanula of 28 April 2023 at p. 2. Your client chose to pursue this issue – using the community's common funds collected through assessments – on behalf of the approximately 21% of the community that were social HOA members at the time. Further, the Board chose to pursue this even though it was entirely likely, if not inevitable, that the legal fees and costs of dispute resolution would ultimately dwarf the *de minimis* annual increase of this reasonable change implemented by my client. As you know, the agreement between the parties requires that the Country Club and the HOA each pay their own legal fees and costs regardless of which party prevails. Accordingly, there is no argument that this decision, which I view as for the benefit of a small minority of the Woodmore community (but half the Board), made financial sense. In the same way, we do not believe that the decision to retain your services, invoke the mediation and arbitration clause and pursue this matter by the Board was for the benefit of the community (i.e., the corporation) as a whole.

In *Kenney,* the Court described an interested director transaction in the following way:

> [U]nder the "interested director" rule, a party may make a showing that a director has a conflict of interest relating to the board's decision—i.e., **that the director, or someone close to that director, has a personal financial interest in the outcome of the board's decision.** *See, e.g.*, *Francis v. Brigham-Hopkins Co.*, 108 Md. 233, 269, 70 A. 95 (1908). If a party makes this initial showing of a conflict of interest, **then the burden shifts to the board to "show that it was just and proper, and that no advantage was taken of the stockholders.**" *Id.*

Cherington Condo. V. Kenney, 254 Md. App. 261, 279–80 (2022) (emphasis added). There can be no reasonable dispute that the social HOA members on the Board were "interested directors" under this rule because they voted to use community funds (i.e. other homeowners' money) to fight for a financial benefit for themselves personally. The conflict is even more apparent when noting that about 79% of the community reaped no direct benefit from the Board's choice to advance this claim no matter the outcome – win, lose or draw.

My review of the record in this case shows no indication that the interested directors disclosed their interest and then recused themselves from the discussion and the vote. The minutes do not reflect this, and it is clear from our conversation that had that issue been addressed, I believe you would have replied so when I raised the concern. Because I see no evidence of disclosure and a vote of only the disinterested board members, the evidentiary burden shifts and the Board will now be forced to prove that the decision to pursue this case and incur the costs was fair and reasonable to all the homeowners in the Woodmore HOA. The *Kenney* Court put it this way when summarizing its holding:

> For the foregoing reasons, we affirm the circuit court's decision to remand the case to the CCOC so that the CCOC may make additional factual findings as necessary to determine whether the landscaping contract and related assessments are **fair and reasonable to the Association and <u>all of its members</u>.**

Kenney at 871 (emphasis added). Applying the law to the facts of our case, forcing the Woodmore HOA Board to prove that the decision to pursue dispute resolution and retain your services to fight the level-loading fee is fair and reasonable to the <u>entire community</u> is difficult. Put plainly, I do not believe a reasonable person could view that decision as advancing the community's interests as a whole. The decision served the interests of only a small subset of the community and even worse, was never economically justified from the beginning. Looking at the evidence objectively, the only logical conclusion any homeowner could draw is that the Board chose to use the community's money unwisely to attempt to gain a benefit that helped the individual directors far more than a victory would help the community as a whole.

Based on what we know, it is also my understanding that there was no community vote authorizing this legal action. It is not even clear to me that the community is aware of the dispute resolution proceedings. As *Kenney* indicates, community approval is a shield that can be used to show an act was in the best interest of the community as a whole. I recognize that my client and I are not privy to all of the Board's communications with the Woodmore community, so if there was in fact a vote of the homeowners' authorizing the action the Board has taken, I am asking you to please indicate as much and provide to me related documents evidencing that vote.

<u>Personal Liability of All Directors</u>

As a general rule, officers and directors are shielded from personal liability for acts of the corporation. But that rule has important and relevant exceptions. The Supreme Court of Maryland summarized those exception:

> [D]irectors are liable for 'gross and culpable negligence' in the discharge or omission of their duties," and that the courts will refuse to intervene only "once it has been determined that [the director's] conduct is neither ultra vires, fraudulent, illegal nor grossly negligent."

Parish v. Maryland & Virginia Milk Producers Ass'n, 250 Md. 24, 75 (1968). Fifteen years later, the intermediate appellate court stated directors may be held liable in the event of "conduct on the part of directors that is fraudulent **or represents a breach of their fiduciary obligations**." *Mountain Manor Realty, Inc. v. Buccheri*, 55 Md. App. 185, 194 (1983).

If the facts are as recounted herein, we think it is clear that both the interested and disinterested directors may have breached their duties to the community as a whole and failed to analyze this decision as they should have – as an interested director transaction that will be subject to close scrutiny and burden shifting. The case law cited noted that directors can be personally liable for conduct that is (1) illegal, (2) grossly negligent or (3) a breach of their fiduciary duties. As set forth above, the Board's handling of this dispute could implicate all three relevant exceptions exposing the Board members to personal liability.

Conclusion

My client's interest in this matter is to verify that any action taken has not only apparent authority, but actual authority under the law. Looking back, the Club contends that the decision itself to pursue dispute resolution and incur costs was not in the best interest of the entire community.

Moving forward, the Club has a right to know whether any agreement that could be reached will actually be binding. Woodmore HOA has an obligation to deal appropriately with the apparent conflict of interests represented by directors who are social HOA Club members. My client has a right to ascertain whether the HOA has the actual authority to resolve this matter. Because that is true, I am requesting that you immediately investigate and verify the facts and conclusions I have presented herein. In resolution of this issue, I am seeking that you provide me with a statement signed by an officer that sets forth the specific facts relevant to the conflicts analysis including but not limited to (1) the date of the vote to authorize moving forward with dispute resolution, (2) the outcome of the vote by individual director name, (3) the names of all directors that participated in the discussion related to moving forward with dispute resolution, and (4) the disclosure, if any, of any director that acknowledged a personal interest in the outcome of the Board's decision to fight level-loading through dispute resolution.

A Note on the Merits of the Dispute

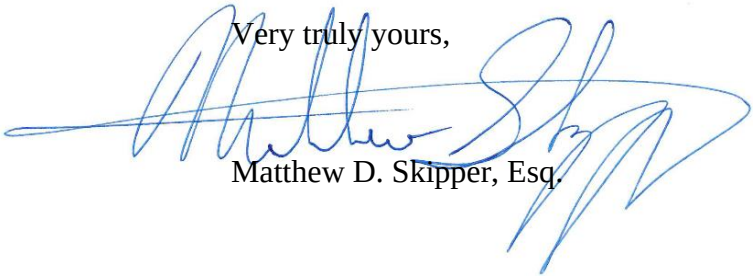
It was not the purpose of this letter to argue the merits of this case. As to level-loading, the settlement agreement is crystal clear that the Club retains all other rights not specifically altered in the agreement. Those rights include the right to add new and additional fees as is typical for all country clubs. I firmly believe that an arbitrator will uphold my client's decision to replace the 22% service fee for a la carte purchases and establish a fixed $40 monthly flat fee. That fee, as you know, is intended to retain staff that often choose to resign their employment during the

offseason. The measure is intended to retain better staff to serve all Club members, and as I noted earlier, has a very limited financial impact.

As to the newly proposed gate card fee, your client's actions of implementing a brand new fee (not replacing a different fee) of $50 per month per gate card for all non-HOA Club members represents an obligation of approximately $150,000 annually. The alleged justification for the gate card fee (the HOA's contributions to the community) were the same claims the HOA advanced in the last round of litigation against the Club. Because those claims were resolved with the settlement agreement we have been referencing, your client is barred from essentially seeking the same alleged damages again after resolving the prior litigation. The decision of the Board to implement the $50 per month gate card fee has now placed the legality of the gatehouse and gates themselves in question because Pleasant Prospect Road is a public road. Indeed, as a direct result of the Board's tactics, Prince George's County has formally been served with a Notice of Claim and draft complaint outlining forthcoming litigation against the County and the HOA challenging the legality of the HOA's obstruction of access to a public road.

I mention the substantive disputes because I did not want my focus to be interpreted as any concern related to the merits of the case. It is both my and my client's firm belief that the HOA's position on both issues is baseless and entirely devoid of merit. That being said, I will look forward to your response related to the conflict of interests raised herein. I look forward to speaking with you.

Very truly yours,



Matthew D. Skipper, Esq.

Cc: Concert Woodmore, LLC