UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Alexandria Division

IN RE:	)	
	)	
GORDON PROPERTIES, LLC and	)	Case No. 09-18086-RGM
CONDOMINIUM SERVICES, INC.,	)	(Jointly Administered)
	)	
Debtors in Possession.	)	Chapter 11
	)	

REPORT OF STEPHEN E. LEACH, AS EXAMINER

D. Marc Sarata, Esq. (Va. Bar. No. 68621)
Kristen E. Burgers, Esq. (Va. Bar No. 67997)
LEACH TRAVELL BRITT pc
8270 Greensboro Drive, Suite 700
Tysons Corner, Virginia 22102
Telephone: (703) 584-8900
Email: msarata@ltblaw.com
Email: kburgers@ltblaw.com

Counsel to Examiner

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REPORT OF EXAMINER

I. Introduction

This Report documents the findings and conclusions of Stephen E. Leach, the duly appointed examiner (the "Examiner") in the chapter 11 bankruptcy cases of Gordon Properties, LLC ("Gordon Properties") and Condominium Services, Inc. ("CSI," and together with Gordon Properties, the "Debtors"), jointly administered as Case No. 09-18086-RGM, in the United States Bankruptcy Court for the Eastern District of Virginia, Alexandria Division (the "Bankruptcy Court").

Pursuant to the Bankruptcy Court's Supplemental Order Directing the Appointment of an Examiner [Dkt. No. 608], entered June 4, 2013, the Examiner has investigated and analyzed:

(a) the procedures and process by which the First Owners Association of Forty Six Hundred Condominium, Inc. ("FOA") approved and entered into that certain Settlement Agreement, dated as of December 11, 2012, by and between FOA,[1] Gordon Properties, CSI, and Gordon Residential Holdings, LLC ("Gordon Residential");[2]

(b) any undue influence or control exercised by Gordon Properties or CSI, or their respective officers or agents, on the board of directors of FOA (the "Board") in connection with the Settlement Agreement;

[1] The Settlement Agreement purports to bind FOA, unit owners, and FOA's officers, directors, Special Litigation Committee members, employees, and agents on the one hand; and Gordon Properties, CSI, Gordon Residential, and their members, shareholders, officers, directors, employees, and agents on the other hand.

[2] Gordon Properties and Gordon Residential are both owed by Bryan Sells, Lindsay Wilson, Elizabeth Greenwell, and Julia Langdon, all family members. Mr. Sells is the Managing Member of both entities. Mr. Sells individually owns Unit 703 of the Forty Six Hundred Condominium (the "Condominium"). Gordon Properties owns 34 commercial units, four residential units, and the larger of two Street-Front Units of the Condominium. Gordon Properties, Gordon Residential, and Mr. Sells collectively have approximately 19.3 percent of the total votes of the membership of the FOA. CSI is wholly-owned by Gordon Properties. Gordon Residential is not in bankruptcy. Gordon Properties, CSI, Gordon Residential, and Mr. Sells are collectively referred to herein as the "Gordon Properties Entities".

(c) whether FOA's approval of the Settlement Agreement satisfied the requirements of Va. Code (1950) § 13.1-871;[3] and

(d) certain related matters as further described below, including, but not limited to, whether it is in the public interest for the Bankruptcy Court to satisfy the condition precedent of the Settlement Agreement that the Bankruptcy Court vacate its Order of July 23, 2012 in Adversary Proceeding 11-1020-RGM [Adv. Proc. Dkt. No. 239], by which the Bankruptcy Court determined that a unit owner of the Condominium that is a single entity and not a natural person may have only one representative seated on the Board at one time, and which is currently on appeal to the United States District Court for the Eastern District of Virginia (Case No. 12cv-01051-TSE-FA).

The Examiner finds that the procedures and process by which FOA (acting through its second Special Litigation Committee) entered into the Settlement Agreement were deeply flawed and imbued with severe conflicts of interest which render the resulting Settlement Agreement of questionable validity, notwithstanding the good faith and hard work of a number of participants in the process. Among other things, the Examiner finds that the Board's creation of both its Special Litigation Committee of June 24, 2012 (the "First SLC"), and its Special Litigation Committee of October 3, 2012 (the "Second SLC," and together with the First SLC, the "SLCs") failed to satisfy Va. Code § 13.1-871 and violated Va. Code § 13.1-869. Because both SLCs were improperly formed under Virginia law, the Board's delegation of settlement authority to the SLCs and the Second SLC's negotiation and approval of the Settlement Agreement were *ultra vires* actions. Accordingly, the Examiner recommends that the Bankruptcy Court withhold approval of the Settlement Agreement unless the Settlement Agreement, in its present or a modified form, is ratified by a majority of the disinterested members of the Board.

[3] All citations hereinafter to the Code of Virginia refer to the Code enacted in 1950, as amended, supplemented, or modified.

The Examiner also finds, as outlined below, that the Settlement Agreement, as currently constituted, contains several provisions that are problematic because they lack clarity (and therefore invite subsequent litigation), are not permitted under Virginia law or FOA's controlling documents, or require the Court to vacate a prior Order without sufficient justification.

II. Process of the Investigation

A. Interviews

To understand the process and procedures by which the SLCs were created, and their subsequent actions in negotiating and approving the Settlement Agreement, the Examiner conducted voluntary[4] in-person interviews of:

1) The five individuals who served on the SLCs: Jane Brungart, Betty Gilliam, Alec Zoghaib,[5] Martina Hernandez, and William Reichenbach[6];[7]
2) Bryan Sells, as the representative of Gordon Properties;[8]
3) Lucia Hadley, Jonathan Halls, and Elizabeth Moore, all former Board members who served during 2012 and/or 2013; and
4) Jennifer Sarvadi, Esq. as a former counsel to the SLCs.[9]

[4] The Examiner determined not to seek to compel any individual or entity to cooperate with his investigation. All communications with, and assistance provided to, the Examiner were voluntary. While the Examiner cannot vouch for the accuracy or completeness of the information provided to him, the Examiner found that all individuals identified in this Report appeared to be both forthcoming and making an effort to be accurate and complete.

[5] Ms. Brungart, Ms. Gilliam and Mr. Zoghaib were the members of the First SLC.

[6] Ms. Brungart, Ms. Hernandez, and Mr. Reichenbach were the members of the Second SLC.

[7] Mses. Brungart and Gilliam were resident unit owners of the Condominium, but were not members of the Board during their tenure on the First SLC (as well as Ms. Brungart's tenure on the Second SLC). Mr. Zoghaib was a non-resident unit owner of the Condominium and a member of the Board during his tenure on the First SLC. Ms. Hernandez and Mr. Reichenbach have been resident unit owners of the Condominium and members of the Board during their tenure on the Second SLC.

[8] The Examiner invited the other owners of Gordon Properties to participate in the interview of Mr. Sells (as a representative of Gordon Properties) or to schedule separate interviews, but only Mr. Sells appeared for an interview.

[9] The SLCs waived any privilege that would restrain Ms. Sarvadi, who at the time of the events discussed in this Report was an attorney with the LeClairRyan law firm, from discussing the activities of the SLCs with the Examiner.

John Donelan, Esq., as counsel to both SLCs, attended and participated in the interviews of the members of the SLCs as well as the interviews of the former members of the Board. Donald King, Esq., as counsel to Gordon Properties and CSI, attended and participated in the interview of Mr. Sells.

The Examiner spoke with Condominium unit owners who contacted him to discuss the Condominium and the Settlement Agreement.[10] The Examiner spoke briefly with former FOA counsel, Michael Dingman, Esq. of Reed Smith LLP, although Mr. Dingman did not discuss any matter he deemed protected by FOA's attorney-client privilege.

Recollections of events, including meetings and decisions of the Board, varied considerably among the individuals interviewed by the Examiner. It is obvious from the emotionally-charged descriptions given to the Examiner that many of the parties have been caught in a maelstrom of accusations, anger, hurt, and paranoia surrounding some of the matters addressed in this Report (and many issues and disputes not addressed herein). The Examiner has endeavored, to the best of his ability, to sort through the theories, rumors, charges, and innuendo to reconcile differing versions of past events.

B. Review of Pleadings, Corporate Records, and Other Documents

The Examiner reviewed many dozens of docket entries from the Gordon Properties and CSI bankruptcy cases, the related adversary proceedings, and the appeals to the U.S. District Court for the Eastern District of Virginia (the "District Court") of various rulings of the Bankruptcy Court in the Debtors' bankruptcy cases. The Examiner also reviewed prior pleadings and rulings of the Circuit Court of Alexandria, Virginia (the "Circuit Court") in *Gordon Properties, LLC v. FOA,* Civil Case No. CL08-001432, *FOA v. Gordon Properties,*

[10] The Examiner did not make any independent effort to contact or otherwise solicit input from individual Condominium unit owners.

LLC, Circuit Court Civil Case No. CL11-004411, *Sobol, et al. v. Sells, et al.*, Circuit Court Civil Case No. CL12-005183, and *FOA v. Dewanda Cuadros, et al.*, Circuit Court Civil Case No. CL12-004429; the filings of the parties in the arbitration between FOA, as claimant, and Gordon Residential and Gordon Properties, as respondent, in AAA 16 0183 0074411; and the Joint Mediation Statement of Gordon Properties and FOA presented to Judge Kevin Huennekens as part of the Bankruptcy Court ordered mediation last year.[11] The Examiner also reviewed FOA's organizational documents, as well as all minutes and resolutions of the Board from and including May 2012 through June 2013.[12] Finally, the Examiner reviewed all materials provided to him by any person in connection with this matter, including but not limited to various documents and financial records provided by members of the SLCs. Copies of all documents referred to in this Report are included in the Appendix hereto.

C. Scope of Examiner's Review

While the Examiner carefully analyzed each element of the Settlement Agreement, the Examiner did not endeavor to assess the litigation risks to be resolved through the Settlement Agreement. In particular, the Examiner did not consider how the District Court might rule on the various pending appeals identified in the Settlement Agreement.[13]

[11] The Examiner appreciates the waiver of confidentiality of the Joint Mediation Statement by Gordon Properties and FOA to assist the Examiner's investigation.

[12] The FOA staff was unable to locate copies of certain FOA records, including certain draft agendas of Board meetings and copies of Board Resolutions 2012-04 and 2012-05, one of which appears to have involved amendments to the Resolution 2012-02, creating the First SLC. Gordon Properties produced copies of all documents requested by the Examiner.

[13] While the Examiner does not presume to know how the District Court would rule on the appeals and other issues before it, it is patently clear that both FOA and the Gordon Properties Entities face serious litigation risk in both the District Court and the Bankruptcy Court. The District Court may reverse, or affirm, the Bankruptcy Court on the question of whether FOA violated the automatic stay as to Gordon Properties when the Board postponed the 2010 Board election. The District Court may reverse, or affirm, the Bankruptcy Court in connection with denial of FOA's claim against Gordon Properties. The Bankruptcy Court may or may not find that the estates of Gordon Properties and CSI should be substantively consolidated in light of Judge Leonie Brinkema's decision remanding the issue to the Bankruptcy Court. Either side could win all open issues, lose all open issues, or face an unsatisfactory "split decision." Under these circumstances, it is in the interests of FOA and the Gordon Properties Entities to settle their differences on fair terms.

Likewise, the Examiner did not attempt to determine FOA's ability to fund continued litigation with the Gordon Properties Entities in the absence of a settlement or FOA's ability to fund the $377,000 in payments required to be made to Gordon Properties under the Settlement Agreement. FOA's economic status has no direct bearing on whether the Settlement Agreement was the product of proper process and procedure.

> Finally, the investigation was conducted over a relatively short timeframe, given the complex history of this case and that the Examiner was appointed roughly three and a half years after Gordon Properties filed its chapter 11 petition.[14] While the Examiner endeavored to learn the material facts of the pre-petition and post-petition disputes between the parties, he did not attempt a complete reconstruction of past events and issues, focusing instead on matters beginning with the seating of the Board elected at FOA's October 2011 annual meeting. The Examiner is concluding his investigation and submitting this Report because he believes that further investigation is unlikely to affect his views and recommendations as to the Settlement Agreement.

III. Findings and Conclusions as to Specific Issues

A. Whether the First SLC Was Properly Created and Populated

1. Background

The most pertinent events leading to the creation of the First SLC are as follows:

In the October 2011 election for all seven Board seats, Gordon Properties, as owner of Unit 328, ran two candidates (Lindsay Wilson and, as a write-in, Dennis Howland). Gordon Residential, as owner of Unit 1518, ran five candidates (Elizabeth Greenwell, Nicholas Greenwell, Moneta Howland, Eliza Langdon, and Deneta Sells). Mr. Sells, the managing member of both Gordon Properties and Gordon Residential, ran for a seat as the owner of Unit 703. Ms. Brungart, herself a candidate for a seat on the Board in the 2011 election, was one of the three signatories on the nominating petitions of Mr. Sells, Ms. Wilson, and all five Gordon

[14] October 2, 2013, will be the fourth anniversary of the Gordon Properties chapter 11 petition for relief. January 26, 2013, was the third anniversary of the CSI chapter 11 petition for relief.

Residential candidates (Ms. Sells, Ms. Greenwell, Mr. Greenwell, Ms. Howland, and Ms. Langdon).[15]

Prior to the October 2011 election, FOA had sued Gordon Residential in the Circuit Court, Civil Action No. CL 2011-004411, seeking, among other things, a declaratory judgment that Gordon Residential, as a non-natural entity, could occupy only one seat on the Board at one time. The Circuit Court entered a preliminary injunction on October 3, 2011, enjoining Gordon Residential from holding more than one Board seat until the lawsuit was resolved. Gordon Properties removed the FOA complaint to the Bankruptcy Court, which remanded the case to the Circuit Court. Subsequently, the matter was referred to arbitration under the auspices of the American Arbitration Association, and designated as matter AAA 16 0183 00744 11 (the "Arbitration"). On January 3, 2012, the Bankruptcy Court entered an order [Dkt. No. 313] modifying the automatic stay of Bankruptcy Code § 362(a), to permit FOA to join Gordon Properties as a party to the Arbitration, which was done on or about January 10, 2012.

On June 15, 2012, the Bankruptcy Court entered an Order ("First Board Order") in Adversary Proceeding No. 11-1020-RGM [Adv. Proc. Dkt. No. 210] finding, among other things, that Gordon Properties and Gordon Residential were limited to two representatives and one representative, respectively, on the Board.[16] The Bankruptcy Court identified Ms. Wilson and Mr. Howland as the elected Gordon Properties directors and Ms. Greenwell as the Gordon Residential director. Together with Mr. Sells, the Gordon Properties directors and the Gordon Residential director thus held four of the seven directors of the Board. The Bankruptcy Court

[15] Mr. Howland, a write-in candidate as an officer of Gordon Residential, does not appear to have prepared a Petition for Nomination.

[16] The Order indicated that the matter had been before the Bankruptcy Court on June 13, 2012 and again on June 15, 2012. The docket of Adversary Proceeding No. 11-1020-RGM reflects extensive briefing by FOA and Gordon Properties on the issue of whether a non-natural entity could hold more than one seat on the Board at the same time.

identified the three directors not affiliated with Gordon Properties as Ms. Hadley, Mr. Pepper, and Mr. Zoghaib.

On July 23, 2012, the Bankruptcy Court entered an Amended Order (the "Amended Board Order") in Adversary Proceeding No. 11-1020-RGM [Adv. Proc. Dkt. No. 239], indicating that the issue of whether a non-natural entity could hold more than one seat on the Board had again been argued before the Court. In the Amended Board Order, the Bankruptcy Court found that, among other things, "[a] unit owner that is a single entity and not a natural person may have only one representative seated on the Board of Directors at one time." In light of this conclusion, the Bankruptcy Court removed Mr. Howland (one of the two Gordon Properties directors seated under the First Board Order) from the Board and replaced him with Ms. Moore, who had received the next highest vote count, excluding candidates disqualified because of their affiliation with Gordon Properties or Gordon Residential. The Amended Board Order further provided that any otherwise valid and effective action of the Board taken under the First Board Order was unaffected by the change in Board membership resulting from the Amended Board Order.

As discussed below, a condition precedent to the Settlement Agreement binding the Gordon Properties Entities is that the Bankruptcy Court vacate the Amended Board Order. The Settlement Agreement provides that such *vacatur* of the Amended Board Order will have no effect on the term of any current Board member and provides that "any member of FOA" shall be entitled to contest "in an appropriate forum in the future the qualification of any particular individual to sit on the Board." Settlement Agreement at ¶ 5.

The Board seated under the First Board Order conducted its first regular meeting on June 19, 2012.[17] FOA has been unable to provide the Examiner with a complete set of the minutes of the June 19 meeting.[18] [19] The minutes of the meeting do reflect, however, that five directors were present in person or by telephone, including the four directors affiliated with the Gordon Properties Entities and Mr. Pepper. The minutes further reflect that Mr. Sells moved that Policy Resolution No. 2009-03 be repealed to the extent it had not previously been rescinded at a prior annual meeting of the members.[20]

Mr. Sells also moved that the Board immediately terminate the retention of Reed Smith, LLP ("Reed Smith") and Redmon, Peyton & Braswell, LLP,[21] and that LeClairRyan be directed to seek a continuance of all filings and hearing dates until replacement counsel could be hired. While the minutes do not reflect the vote on the motion to terminate Reed Smith, given that the meeting was attended by the four directors affiliated with the Gordon Properties Entities and only one non-affiliated director, the motion could only have passed with the votes of the directors affiliated with the Gordon Properties Entities.[22] The result was that the directors

[17] The Board conducted a brief organizational meeting on June 17, 2012, at which the following FOA officers were selected: President: Bryan Sells; Vice President: Elizabeth Greenwell; Secretary: Lucia Hadley; and Treasurer: Betty Gilliam.

[18] The Examiner believes the minutes of the June 19, 2012 meeting, as produced by FOA, are incomplete. They end with the section heading "EXECUTIVE SESSION" and contain no reference to adjournment of the meeting or to post-executive session proceedings as is the case with the minutes of virtually all other regular Board meeting minutes produced to the Examiner.

[19] Certain members of the SLCs and former Board members have questioned the accuracy and completeness of elements of the minutes of the Board meetings addressed in this Report. Nonetheless, the Examiner has accepted the substantial accuracy of those minutes.

[20] Policy Resolution No. 2009-03, entitled "Eligibility for Election to the Board of Directors" ("Resolution 2009-03") purported to delineate certain rules and restrictions regarding membership on the Board. Among other things, the Resolution provided that neither multiple owners of a single unit of the Condominium, nor the owner of multiple units of the Condominium, could hold more than one Board seat. The Examiner takes no position as to whether the Board had authority under the FOA By-Laws to adopt Resolution 2009-03.

[21] Redmon, Peyton & Braswell briefly served as FOA co-counsel with Reed Smith.

[22] Ms. Sarvadi, former FOA and SLC counsel, has advised the Examiner that she attended the June 19, 2012 meeting and that the Board voted both to repeal Resolution 2009-03 and to terminate the services of Reed Smith. Ms. Sarvadi's recollection as to the termination of Reed Smith is confirmed by a June 20, 2012 email from Reed Smith to the arbitrator in the Arbitration, advising that FOA had terminated Reed Smith as its counsel.

affiliated with the Gordon Properties Entities fired the law firms that were opposing Gordon Properties and Gordon Residential on behalf of FOA in multiple matters.

The Board's firing of Reed Smith on June 19, 2012, was potentially damaging to the litigation interests of FOA. The evidentiary hearing in the Arbitration of the issues relating to the right of Gordon Properties and Gordon Residential to hold multiple seats on the Board was scheduled for June 28 and 29, 2012, and the parties had just exchanged exhibits, witness lists, and position statements on June 15, 2012. Reed Smith's termination forced a postponement of the Arbitration, which has never been completed (although the dispute would be resolved under the Settlement Agreement, if approved). Similarly, Reed Smith had been representing FOA in its appeal of the Bankruptcy Court's denial of FOA's motion to have the Gordon Properties and CSI bankruptcy estates substantively consolidated. Oral argument before Judge Brinkema on the substantive consolidation appeal was scheduled for June 29, 2012. FOA engaged Ms. Sarvadi of LeClairRyan on an emergency basis to handle the oral argument. Ms. Sarvadi entered her appearance in the appeal on June 27, two days before oral argument, and filed a motion for a continuance which the District Court denied, forcing Ms. Sarvadi to present oral argument for FOA with limited opportunity for preparation.[23]

The Board next convened for a special meeting on Sunday, June 24, 2012, attended in person or by telephone by all seven directors. At the meeting, Ms. Hadley moved to retain Michael Dingman of Reed Smith to represent FOA in the "Brinkema appeal."[24] Mr. Sells moved to table the motion. The motion to table passed 4 to 3 with the four Gordon Properties affiliated

[23] Notwithstanding the limited time available for Ms. Sarvadi, as emergency replacement counsel, to prepare for oral argument, the District Court reversed and remanded the Bankruptcy Court's denial of the FOA's substantive consolidation motion, thus handing FOA a "victory" of a sort. Nonetheless, the Examiner concludes that the Board's firing of long-standing counsel eight days before the dispositive evidentiary hearing in the Arbitration and nine days before oral argument on an important appeal was imprudent to the point of irresponsibility.

[24] The "Brinkema appeal" was the appeal of the Bankruptcy Court's denial of FOA's substantive consolidation motion described above.

directors voting in favor of tabling the retention motion and the three "disinterested" directors voting against. The Board never subsequently considered Ms. Hadley's motion to hire Reed Smith.

Ms. Hadley then moved to retain Reed Smith to argue the "By-Laws issue."[25] Mr. Sells again moved to table the motion. This motion to table also passed 4 to 3 with the four Gordon Properties affiliated directors voting in favor of tabling the retention motion and the three "disinterested" directors voting against. The Board never subsequently considered this second motion to hire Reed Smith.

Through the foregoing votes, the Gordon Properties affiliated directors blocked the efforts of the disinterested directors to engage the counsel of their choice to represent FOA in on-going disputes with Gordon Properties and Gordon Residential.

Mr. Sells then moved for approval of a three-page resolution, which he had drafted and which became "Administrative Resolution No. 2012-02 'Appointing Special Litigation Committee'" (the "First SLC Resolution").[26] After preliminary votes, the Board adopted the First SLC Resolution by a vote of 4 to 3, with the four Gordon Properties affiliated directors voting in favor and the three disinterested directors voting against.

The First SLC Resolution speaks for itself, but among other things, it created the First SLC, comprised of Ms. Brungart, Ms. Gilliam, and Mr. Zoghaib, who were delegated "all the Board's power and authority to investigate and determine the Association's position with respect to the Litigation."[27] The "Litigation" was defined as "all pending litigation and arbitration

[25] The "By-Laws issue" was the Arbitration of the Board membership issues described above.

[26] Mr. Sells has suggested that Ms. Sarvadi assisted in the drafting of the First SLC Resolution. The Examiner concludes that Ms. Sarvadi was involved only in making suggested revisions to the First SLC Resolution after its adoption by the Board.

[27] None of the individuals named to the First SLC recalled having been asked by Mr. Sells in advance as to their interest in serving on the committee, although all three did agree to serve on the committee when notified of their selection.

involving FOA, its current and former Board members, Gordon Properties, Gordon Residential, and CSI (collectively, the 'Litigation')."

2. Analysis and Conclusions

(a) The Appointment of the First SLC Did Not Satisfy the Requirements of the Virginia Code for Conflict of Interests Transactions.

The Examiner concludes that the Board's creation of the First SLC under the First SLC Resolution did not satisfy the requirements of Va. Code § 13.1-871. As an initial matter, the four Gordon Properties affiliated directors were not "disinterested" directors as to the selection of a committee to represent FOA in litigation and arbitration against the Gordon Properties Entities. Under Va. Code §13.1-871(A) and (B), a "conflict of interests transaction" is not voidable by a corporation "solely because of the director's interest in the transaction" if either of the following is true: (a) the material facts of the transaction and the director's interest were known or disclosed to the board of directors, and a majority of disinterested directors voted to approve the transaction; or (b) the transaction was "fair" to the corporation.[28]

First, a majority of disinterested directors did not vote to approve the creation and appointment of the First SLC. The disinterested directors unanimously opposed the First SLC Resolution, which was adopted solely with the votes of the four "interested" Gordon Properties directors. Accordingly, the "safe-harbor" provision of Va. Code § 13.1-871(B), which requires the affirmative vote of a majority of the three disinterested directors, was not satisfied. Further, under Va. Code § 13.1-871(B), because a majority of the disinterested directors did not approve the First SLC Resolution and because the disinterested directors did not themselves constitute a quorum of the Board, no quorum was present at the June 24, 2012 meeting for the purpose of

[28] A third "safe-harbor" alternative, not applicable here, occurs when the material facts of a transaction and the director's interest are disclosed to a corporation's members entitled to vote and they approve the transaction. Va. Code § 13.1-871(A)(2).

taking action on the First SLC Resolution. Thus, the Board's creation of the First SLC in the absence of a quorum, was an *ultra vires* action.

Second, the Examiner concludes that the First SLC Resolution was not "fair" to the corporation.[29] While the concept of what is "fair" is clearly subject to different definitions and interpretations, the Examiner concludes that it is inherently unfair for one party in litigation to select who will represent the interests of its opponent in that litigation. It is a matter of common sense that one will select an opponent, if given the opportunity, who will best serve one's own interests, not that of one's opponent. That is not how a fair adversarial system functions. The selection of a special litigation committee could be fair to FOA only if it were the creation of, and answered solely to, disinterested directors.

The absence of "fairness" to FOA in connection with the First SLC Resolution is further indicated by the provision in its paragraph 4, prohibiting the First SLC from engaging any counsel that had represented any party to the Litigation at any time after July 1, 2006. This provision had the effect of barring the First SLC from engaging Reed Smith or LeClairRyan, among other law firms. Whether or not the First SLC was of a mind to employ Reed Smith or LeClairRyan is beside the point – it is inherently unfair for one side in litigation to limit the other side from engaging counsel of the other side's choice, except in connection with a conflict of interest under legal ethics rules of practice.[30] [31] Moreover, the restriction was entirely one-sided:

[29] The Virginia Nonstock Corporation Act does not define "transaction," but the Examiner concludes that the common understanding of "transaction" would include the Board's creation of, and delegation of its authority to, a special purpose committee such as the First SLC.

[30] As is discussed above, pursuant to the Amended Board Order of July 23, 2012, Ms. Moore, a disinterested director, replaced Mr. Howland, a Gordon Properties affiliated director, on the Board. At a special meeting of the Board on September 3-4, 2012, the Board adopted resolutions striking from the First SLC Resolution that part of Paragraph 4 restricting the First SLC's right to hire post-July 1, 2006 counsel and that part of Recital D declaring that the conduct of Ms. Hadley and Mr. Pepper, along with the conduct of other former Board members, had been found to be a willful violation of law. These provisions were struck in each case by a 4 to 3 vote, with the disinterested directors voting in favor and the Gordon Properties directors voting against. It appears to the Examiner that the striking of the foregoing First SLC Resolution was reflected in Administrative Resolution 2012-04 or Administrative Resolution 2012-05, but the FOA staff has been unable to locate a copy of these Resolutions. On October 3, 2012, one month later, upon the election of three new members to the Board, Mr. Sells restored the stricken provisions through

while the First SLC had to engage entirely new counsel, Gordon Properties and CSI continued to use their long-standing counsel, Odin Feldman & Pittleman, P.C., whose attorneys were intimately familiar with the history of the disputes between them and the FOA.[32]

Article VII, Section 2 of the FOA By-Laws (the "By-Laws") addresses "common or interested" directors. This provision of the By-Laws appears to provide that the votes of interested directors are to be counted notwithstanding a director's "interested" status as to a contract or transaction, provided the director's status as "interested" is disclosed or known to the board. Nonetheless, this provision conflicts with Va. Code § 13.1-871, which was enacted after FOA adopted the By-Laws. Va. Code § 13.1-814.1 provides that in certain instances, the by-laws of a community association in existence as of January 1, 1986, shall continue to govern. Rules as to conflicts of interest transactions are not among the provisions "saved" by Va. Code § 13.1-814.1, and thus the By-Laws relating to the votes of interested directors on contracts or transactions are subordinate to the requirements of Va. Code § 13.1-871 to the extent they conflict with that provision.

(b) The First SLC Was Not Comprised Solely of Directors in Violation of the Virginia Code.

The Examiner concludes that the Board's creation of the First SLC did not satisfy the requirements of Va. Code § 13.1-869, which regulates the creation and authority of board of

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passage of the Second SLC Resolution, which is discussed below. Also at the September 3-4, 2012 special meeting, a resolution to reconsider the First SLC Resolution in order to change its membership was defeated by a 2 to 5 vote, with disinterested directors Ms. Hadley and Mr. Pepper in favor, disinterested directors Ms. Moore and Mr. Zoghaib opposed, and the three Gordon Properties directors opposed. Disregarding the votes of the interested Gordon Properties directors, the motion failed 2 to 2.

[31] The First SLC Resolution's restriction on who the First SLC could engage as counsel had practical consequences: Ms. Sarvadi has advised the Examiner that the First SLC initially concluded that it could not engage her as FOA counsel in the Arbitration or in connection with FOA's appeal of the Bankruptcy Court's denial of the FOA proof of claim because of the restriction on counsel in the First SLC Resolution. In September, 2012, after revisions to the First SLC Resolution described in the preceding Footnote 28, which removed the restrictions on the selection of counsel, the First SLC engaged Ms. Sarvadi to handle FOA's appeals' litigation and the Arbitration. The Second SLC terminated Ms. Sarvadi's services in October 2012.

[32] Likewise, Gordon Residential and Gordon Properties continued to use their long-standing counsel, MercerTrigiani, in the Arbitration.

directors committees. Va. Code § 13.1-869 provides that a board of directors may create one or more committees and "appoint members of the board of directors to serve on them." Such a board-created committee, comprised of a subset of board members, may then be authorized to exercise the authority of the entire board with certain specified exceptions not relevant here. But Va. Code § 13.1-869 does not empower a board to create a committee that includes non-board members who will then receive and exercise the board's authority.

Notwithstanding the limitations of Va. Code § 13.1-869, the First SLC was comprised of two non-board members (Ms. Brungart and Ms. Gilliam[33]) and only one board member (Mr. Zoghaib). The Board could not properly delegate its authority to a committee that included non-board members.[34]

Recital D of the First SLC Resolution refers to the fact that Gordon Properties then had a pending lawsuit against two of the Board's current members, Ms. Hadley and Mr. Pepper, and that their conduct "together with other members of the FOA's former Board of Directors, was found to be a willful violation of law."[35] The import of Recital D appears to be that the Gordon Properties lawsuit and the Automatic Stay Ruling disqualified Ms. Hadley and Mr. Pepper from membership on the First SLC, thus leaving Mr. Zoghaib as the sole disinterested director on the Board. Va. Code § 13.1-869(A) requires that a committee of a board of directors have at least

[33] Ms. Gilliam was the treasurer of FOA and thus an officer. Ms. Brungart was a unit owner only. Both Mses. Gilliam and Brungart had previously served on the Board. That Ms. Brungart had signed the 2011 Petitions for Nomination of Mr. Sells and the six other Board candidates affiliated with Gordon Properties was not disqualifying. Nonetheless, once Mr. Sells determined to propose non-Board members for the First SLC, there were presumably other Condominium unit owners who would have been willing and able to serve and who had not actively endorsed the 2011 candidates of the Gordon Properties Entities. The appointment of Ms. Brungart to the First SLC (and later to the Second SLC, as discussed below) creates the appearance that Mr. Sells placed a personal supporter on the committee that was to negotiate across the table from the Gordon Properties Entities.

[34] While the Examiner has concluded that Mses. Brungart and Gilliam were not proper members of the First SLC, he in no way questions their good faith, diligent efforts, and hard work on behalf of the First SLC and FOA.

[35] The "willful violation of law" was presumably a reference to the Bankruptcy Court's ruling of September 20, 2011 [Adv. Proc. No. 11-1020-RGM Dkt. No. 83] that the Board's indefinite postponement of the 2010 Board election was a violation of the automatic stay of 11 U.S.C. § 362(a) (the "Automatic Stay Ruling").

two members. Even assuming that Ms. Hadley and Mr. Pepper were disqualified from membership on the First SLC for the reasons suggested in Recital D (a proposition with which the Examiner disagrees), the absence of more than one disinterested director did not justify the Board's delegation of its authority to a committee that included non-directors.[36] To the contrary, if there had been an insufficient number of disinterested directors, the solution was not for the Gordon Properties affiliated directors to cause the Board to create a formal committee with inappropriate members. Instead, the Gordon Properties directors could and should have recused themselves from all matters relating to the litigation and the Arbitration between the Gordon Properties Entities and FOA, and left FOA's management of those matters solely to the disinterested directors.[37]

Recital G of the First SLC Resolution refers to Article VI, Section 4 of the By-Laws, which empowers the president of FOA to create committees from among the FOA membership. This provision is irrelevant to the First SLC, which was created by the Board (even though Mr. Sells drafted and moved the adoption of the First SLC Resolution). Nothing in Article VI, Section 4 of the By-Laws suggests that the president of FOA is empowered, or could be empowered, to create a committee that would then exercise the authority of the Board, as was the case with the First SLC.

[36] By virtue of the Bankruptcy Court's Amended Board Order of July 23, 2012, Ms. Moore replaced Mr. Howland on the Board. Gordon Properties was also suing Ms. Moore. Unless one accepts the notion that either Gordon Properties lawsuit or the Automatic Stay Ruling disqualified directors from managing FOA litigation against the Gordon Properties Entities, then as of July 23, 2012, there were four disinterested directors who could have served on the First SLC: Ms. Hadley, Ms. Moore, Mr. Pepper, and Mr. Zoghaib.

[37] Even if Ms. Hadley, Ms. Moore, and Mr. Pepper were not disinterested under Va. Code 13.1-871, Mr. Zoghaib was available as a disinterested director to direct the FOA's position on litigation – there was no need for the creation of a special committee if insufficient members were available.

In light of the foregoing, the Examiner concludes that the creation of the First SLC did not satisfy the requirements of Va. Code § 13.1-871 and that the placement of non-directors onto the First SLC was an *ultra vires* act under Va. Code § 13.1-869.[38]

(c) Termination of the First SLC.

First SLC members and counsel report that it took until approximately the start of August, 2012, for the Committee to identify and engage counsel (Mr. Donelan) who had no prior involvement in the lawsuits between the Debtors and FOA. Because he was starting from scratch, Mr. Donelan reports that it took him two to three weeks to familiarize himself with the long and complex history of the disputes between the parties. Thus, because of the First SLC's resolution's prohibition on the use of counsel with prior experience in the disputes between the parties, the First SLC was without legal assistance until roughly the start of September 2012. The Examiner has also been advised that when the First SLC sought the assistance of the Reed Smith and LeClairRyan law firms, notwithstanding the initial restriction on who the Committee could hire, Mr. Sells was upset and questioned the First SLC's authority to engage those firms.[39]

Based on discussions with counsel for the First SLC and its members, the Examiner concludes that Gordon Properties' demand that the Bankruptcy Court's *vacatur* of the Amended Board Order be a condition precedent to the any settlement, and the First SLC's refusal to consider *vacatur* or modification of the Amended Board Order, brought negotiations (when they

[38] Va. Code §§ 13.1-870.1 and 13.1-870.2 address limitations on the liability of a corporation's officers and directors. Ms. Gilliam, as treasurer, and thus an officer of FOA, would typically have enjoyed the protections of this Code provision. Ms. Brungart, who was neither an officer nor director of FOA, was unprotected. Likewise, Article VII, Section 1 of the FOA By-Laws provides FOA directors and officers with indemnification rights under certain circumstances. That Ms. Brungart was protected by neither the limitation of liability provisions of the Virginia Nonstock Corporation Act nor the By-Laws, makes her selection to, and participation on, the First SLC particularly inappropriate, especially in this case where a number of former Board members and officers had been sued threatened with suit. To help insure independent action, a member of a board of directors' committee should exercise his or her authority only under the liability umbrella created by statute and corporate by-laws.

[39] As noted above, at the Special Meeting of the Board on September 3-4, 2012, the restriction on the First SLC's selection of counsel was removed from the First SLC Resolution by a 4 to 3 vote, with the four disinterested directors in favor and the three Gordon Properties directors opposed.

could begin in earnest after Mr. Donelan's engagement), to an impasse. The Examiner concludes that Mr. Sells resolved the impasse by having the Board dissolve the First SLC on October 3, 2012, and replace it with the Second SLC. The First SLC had not reported to the Board that it could not function or that further negotiations would necessarily prove fruitless. Its members and counsel report that they received no advance notice of Mr. Sells' desire to dissolve and replace it, nor did they have an opportunity to defend its work before the full Board or the disinterested directors thereof. It is hard to avoid the conclusion that Mr. Sells asked the Board to dissolve and replace the First SLC because he was dissatisfied with the independence shown by the First SLC and was looking for a negotiating counterpart which would be more receptive to the settlement demands of the Gordon Properties Entities.

The Board's termination of the First SLC is all the more problematic because on September 13, 2012, the Bankruptcy Court had referred the Gordon Properties and CSI bankruptcy cases and all ancillary arbitrations and litigation to mediation with Judge Kevin R. Huennekens of the U.S. Bankruptcy Court for the Eastern District of Virginia in Richmond, Virginia. The Board thus dissolved and replaced the First SLC before it had any reasonable opportunity to assert its views through the mediation process directed by the Bankruptcy Court.

B. Whether the Second SLC Was Properly Created and Populated

1. Background

The October 3, 2012 Board election was for the seats held by Ms. Moore, Mr. Pepper, and Mr. Zoghaib.

Martina Hernandez vigorously campaigned for a seat on the Board by soliciting proxies from other unit owners. She reports that she succeeded in collecting and controlling a large number of proxies. She also reports having had an agreement with Mr. Sells that she would vote

her proxies for candidates favored by the Gordon Properties Entities and, in turn, the Gordon Properties Entities would vote for her.[40] Unit owner William Reichenbach had not submitted a nominating petition, his name was not on the pre-printed election ballot, and he did not campaign for votes. He reports, however, that he made it known to others that if he were elected to the Board, he would seek a resolution of all of the lawsuits between FOA and the Gordon Properties Entities.

On the evening of the election, Ms. Hernandez reports that Mr. Sells unexpectedly asked her to vote for Mr. Reichenbach (as a write-in candidate). Ms. Hernandez further reports that she did not then know Mr. Reichenbach or anything about him and was reluctant, therefore, to vote for someone who had not campaigned and with whom she was unfamiliar. Nonetheless, she agreed to Mr. Sells' request and cast the votes she controlled for Mr. Reichenbach. Mr. Sells reports that the Gordon Properties Entities supported Mr. Reichenbach and Ms. Hernandez, who were both elected to the Board, together with Jonathan Halls.[41]

In light of the October 3, 2012 election results, the "new" Board was comprised of three Gordon Properties directors (Mr. Sells, Ms. Greenwell, and Ms. Wilson), plus Ms. Hadley, Mr. Halls, Ms. Hernandez, and Mr. Reichenbach.

At 11:04 p.m.[42] on October 3, 2012, immediately following the election, five members of the new Board held an organizational meeting. The Gordon Properties directors, Mr. Sells, Ms. Greenwell, and Ms. Wilson, were present, together with newly elected directors, Ms. Hernandez and Mr. Halls. No advance notice of the meeting appears to have been given. Ms. Hadley, who had attended the election, left before the organizational meeting began and without knowledge

[40] The Examiner does not suggest that such an agreement among unit owners as to how they would vote was improper.

[41] Thus Ms. Moore, Mr. Pepper, and Mr. Zoghaib left the Board as of October 3, 2012.

[42] The meeting began at 11:04 p.m. and adjourned at 12:04 a.m. on October 4, 2012.

that it was about to occur. Mr. Halls, who attended the meeting, learned of it only immediately before it was convened and had no opportunity to prepare for any of the matters then debated and decided. Mr. Reichenbach was on vacation and did not attend the election or the meeting. The meeting began with the election of officers. By 5 to 0 votes, Mr. Sells was re-elected as FOA president, Ms. Greenwell was re-elected as vice president, and Ms. Wilson was appointed as both secretary and treasurer. Thus all four FOA officer positions were (and are currently) held by Gordon Properties directors.

During the meeting, Mr. Sells presented the Board with a resolution (the "Second SLC Resolution") that he had drafted, providing for (1) the repeal of all prior Board resolutions creating a Special Litigation Committee and (2) the creation of a Second SLC with new members.[43] The minutes of the meeting reflect discussion about the fact that there were now three directors, "none of whom are conflicted with regard to acting on behalf of FOA in legal matters, namely Martina Hernandez, Jonathan Halls and William Reichenbach." The implication of these statements is that Ms. Hadley was (again) viewed as ineligible for membership on a special litigation committee relating to management of FOA's disputes with the Gordon Properties Entities. Mr. Halls immediately declined to serve on a new litigation committee and suggested instead that Ms. Gilliam serve "for purposes of continuity."

The meeting minutes state that Ms. Wilson moved that the Second SLC Resolution "be adopted as written" and that Ms. Hernandez, Mr. Reichenbach, and Ms. Brungart[44] be appointed

[43] The formal title of the Second SLC Resolution is "Administrative Resolution 2012-06". Immediately below the title is the legend "Replaces Administrative Resolution 2012-05." FOA was unable to provide the Examiner with a copy of Administrative Resolution 2012-05 (or Administrative Resolution 2012-04, presuming one exists). In light of the Board's revisions to the First SLC Resolution adopted at the special meeting of September 3-4, 2012, the Examiner assumes that Administrative Resolution 2012-05 reflected the Board's September 3-4, 2012 revisions to the First SLC Resolution.

[44] Ms. Brungart thus became a non-director member of the Second SLC. In contrast to the First SLC, which had two non-directors and only one director, the Second SLC has two directors and one non-director.

to the Second SLC.[45] The Board adopted the Second SLC Resolution by a vote of 4 to 1, with the three Gordon Properties directors and Ms. Hernandez in favor and Mr. Halls opposed. Had the Gordon Properties directors recused themselves, or had their votes not been considered, the Second SLC Resolution would have failed by a vote of 1 to 1. Had the resolution failed, the First SLC would have continued to represent the FOA in the disputes with the Gordon Properties Entities.

As noted, the October 3, 2012 meeting was not a regular meeting of the Board. Because no one could know in advance who would be elected to the Board earlier that evening, it was not practical for notice of the organizational meeting to have been provided (at least to newly elected members of the Board). The inability to provide notice is demonstrated in this case by the fact that one of the newly-elected Board members (Mr. Reichenbach) was a write-in candidate who was not present at the election. The Examiner has not found authority concerning the business a board may properly address at an organizational meeting such as the one held on October 3, 2012. The Examiner presumes that an organizational meeting (if properly called) would address such matters as the election of new officers as was done at the start of this meeting. The Examiner questions, however, whether dissolution of the First SLC and the creation and selection of the Second SLC, were proper items for consideration under the circumstances.

The Board adopted Mr. Sells' Second SLC Resolution without prior notice that the matter would be considered. The three members of the First SLC and its counsel all report that they were unaware of Mr. Sells' intention to move for the Board to replace the First SLC with a new committee – they learned of the First SLC's termination after-the-fact. Likewise, none of the members of the Second SLC was aware beforehand that he or she would be placed onto the

[45] The minutes do not reflect any discussion of Mr. Halls' suggestion that Ms. Gilliam be named to the Second SLC, or why Ms. Brungart was selected.

Second SLC (although Ms. Hernandez was present at the October 3 meeting and voted for the Second SLC Resolution). Further, neither Ms. Hadley nor Mr. Halls had prior notice of the organizational meeting on October 3, 2012 or of the Second SLC Resolution.

The Second SLC Resolution contained a comprehensive delegation of Board authority to the Second SLC over the management and disposition of the litigation and the Arbitration between FOA and the Gordon Properties Entities. In particular, the Second SLC Resolution provided in paragraph 4:

> 4. The Board of Directors delegates to the Special Litigation Committee all of the Board's power and authority to direct and manage and determine the Association's position with respect to the Litigation, including, but not limited to, the power to direct FOA's counsel, and to settle the Litigation on terms deemed reasonable and in the best interests of the Association….

The Board thus effectively delegated to the Second SLC control of the financial assets of FOA because the Second SLC could, in theory, bind FOA to pay virtually any amount of money to the Gordon Property Entities in settlement of the "Litigation."[46]

As had the original version of the First SLC Resolution, the Second SLC Resolution contained a restriction on the Second SLC's choice of counsel. In particular, paragraph 5 prohibited the Second SLC from engaging any counsel who had represented any party to the Litigation between July 1, 2006 and June 15, 2012. This restriction barred the Second SLC from engaging, among others, Reed Smith and LeClairRyan, both of whom had represented FOA against the Gordon Properties Entities during the specified time period and who had necessarily accumulated substantial "institutional knowledge" about the facts, issues, and risks relating to the Litigation the Second SLC was charged with managing.

[46] The definition of "Litigation" in the Second SLC Resolution is substantially similar, but not identical, to the definition of "Litigation" in the First SLC Resolution.

The Board convened a regular meeting on October 16, 2012. All seven directors were present. At the meeting, Ms. Wilson moved that the Board ratify its actions taken at the October 3, 2012 organizational meeting, which included the Board's adoption of the Second SLC Resolution. The minutes reflect that Mr. Halls raised concerns about possible conflicts of interest when "conflicted" Board members vote to appoint a special litigation committee. The minutes reflect further discussion of the appointment of new Board members "who are not in apposition [sic] of conflict" as appropriate candidates to serve on the Second SLC.

The motion to ratify the Second SLC Resolution and other acts at the October 3, 2012 meeting passed by a vote of 5 to 2, with the three Gordon Properties directors plus Ms. Hernandez and Mr. Reichenbach in favor, and Mr. Halls and Ms. Hadley opposed. Had the Gordon Properties directors not voted, or had their votes not been counted, the indirect ratification of the Second SLC Resolution would have failed by a vote of 2 to 2.[47]

The Second SLC engaged the services of Mr. Donelan, who had been engaged by the First SLC. The Second SLC also met with Ms. Sarvadi at its first meeting, but terminated her services at its second meeting in or about the middle of October, 2012.

Through the mediation efforts of Judge Huennekens, and with the assistance of counsel, the Second SLC entered into settlement negotiations with the Gordon Properties Entities. In contrast to the First SLC, the Second SLC acceded to the demand of the Gordon Properties Entities that settlement be conditioned on the Bankruptcy Court's *vacatur* of the Amended Board Order. The Second SLC also agreed that the settlement not release claims by Gordon Properties against certain former Board members and officers arising from their conduct during their

[47] As previously noted, the Examiner does not agree that Ms. Hadley was not disinterested as to the litigation with Gordon Properties because she has been sued by Gordon Properties, opposed the Gordon Properties Entities on various matters, or as a result of the Automatic Stay Ruling.

service as officers or directors of FOA.[48] The Second SLC and the Gordon Properties Entities also agreed to a permanent "cap" on FOA's assessment against the "Street-Front Unit"[49] owned by Gordon Properties:

> 11. The annual assessment against the Street-Front Unit shall not exceed $30,000.00 (the "Assessment Cap"). This Assessment Cap shall apply to all future assessments against the Street-Front Unit, notwithstanding any sale or transfer by Gordon Properties of its interest in the Street-Front Unit. Notwithstanding the foregoing, the Assessment Cap may be exceeded in any assessment year with the prior written consent of Gordon Properties (or the then-owner of the Street-Front Unit), which consent shall not be unreasonably withheld."

The Second SLC also agreed that FOA would pay Gordon Properties $377,000 in ten semi-annual installments.

The foregoing provisions and others were incorporated into the proposed Settlement Agreement. All three members of the Second SLC agreed to the terms of the Settlement Agreement, which was signed on behalf of the Second SLC by Mr. Donelan as "Counsel for FOA."[50]

[48] This "carve-out" applies to Ms. Hadley, Ms. Moore, Mr. Pepper, Dewanda Cuadros, Corey Brooks, Jerry Terry, and Kevin Broncato (collectively, the "Carve-Out Defendants"). In connection with the "carve-out, it is noteworthy that on October 7, 2011, Gordon Properties sued the Board itself, as well as the Carve-Out Defendants, in the Circuit Court, Case No. CL-11-004700. Gordon Properties asserted claims against the Board and the Carve-Out Defendants for fraud and breach of fiduciary duty, election fraud, and statutory business conspiracy relating to the conduct of FOA's 2009 and 2010 annual meetings and Board elections.

[49] The Street-Front Unit is a 63,171 square foot pad site occupied by a "Mango Mike's" restaurant. The Circuit Court has found the Street-Front Unit responsible for 11.32 percent of the Condominium's Common Elements expenses. *See* Footnote 1, Circuit Court Letter Opinion of February 23, 2009, Civil Case CL08-001432.

[50] Ms. Hernandez now opposes approval of the Settlement Agreement. Nonetheless, she acknowledges that she voted with the other members of the Second SLC to accept the Settlement Agreement.

2. Analysis and Conclusions

(a) The Appointment of the Second SLC Did Not Satisfy the Requirements of the Virginia Code for Conflict of Interests Transactions.

The Examiner concludes that the Board's creation of the Second SLC under the Second SLC Resolution did not satisfy the requirements of Va. Code § 13.1-871. The Examiner's reasons for concluding that the creation of the Second SLC did not satisfy the requirements of Va. Code § 13.1-871 are substantially similar, albeit not identical because of differing facts, to the Examiner's conclusion that creation of the First SLC did not satisfy Va. Code §13.1-871. As an initial matter, the three Gordon Properties affiliated directors were not "disinterested" as to the selection of a committee to represent FOA in litigation and arbitration against the Gordon Properties Entities.

At the October 3, 2012 organizational meeting, the vote of the only disinterested directors in attendance (Ms. Hernandez and Mr. Halls) on the Second SLC Resolution was 1 to 1 with Ms. Hernandez in favor and Mr. Halls opposed. Thus, the Second SLC Resolution did not receive a majority of the votes of the disinterested directors, and the "safe-harbor" provision of Va. Code § 13.1-871(B), which required the affirmative vote of a majority of the disinterested directors, was not satisfied. Further, under Va. Code § 13.1-871(B), because a majority of the disinterested directors did not approve the Second SLC Resolution, no quorum was present at the October 3, 2012 meeting for the purpose of taking action on the Second SLC Resolution. The Board's creation of the Second SLC in the absence of a quorum was an *ultra vires* action.[51]

The Examiner also concludes that the Second SLC Resolution was not "fair" to the corporation for essentially the same reasons the Examiner found the First SLC Resolution to not

[51] Va. Code § 13.1-871(B) is not entirely clear (at least to the Examiner) as to whether the quorum requirement refers to a majority of all disinterested directors or only a quorum of disinterested directors in attendance at a particular meeting. Regardless of the correct interpretation, neither a majority of the disinterested directors overall nor those in attendance at the October 3 meeting, approved the Second SLC Resolution, and thus no quorum was achieved for consideration of the Second SLC Resolution.

be "fair" to FOA – in an adversarial proceeding, it is incontrovertibly unfair for one side to select its opponent's representatives. The inherent lack of fairness to FOA is further suggested by the dissolution of the First SLC and the creation of the Second SLC. The minutes of the October 3 organizational meeting provide no explanation or attempt to justify the replacement of one committee for the other. To the contrary, the action of Mr. Sells and the other Gordon Properties affiliated directors can reasonably be viewed as a reaction to the First SLC's show of independence in the selection of counsel and its resistance to the demand for *vacatur* of the Amended Board Order.

It is also troubling that Mr. Sells (and the other interested directors) selected two individuals whose Board candidacy he either ensured was successful (such as Mr. Sells' mutual-support agreement with Ms. Hernandez) or orchestrated completely (Mr. Sells controlled the Gordon Properties Entities votes and obtained the agreement of Ms. Hernandez to vote her proxies to elect Mr. Reichenbach, a write-in candidate who had not campaigned or filed a Petition for Nomination). It is clear that Mr. Sells saw Mr. Reichenbach's election to the Board and appointment to the Second SLC as desirable for the Gordon Properties Entities.[52] The selection of a special litigation committee could be fair to FOA only if it was the creation of, and answered solely to, the disinterested directors. It was inappropriate for Mr. Sells and the other Gordon Properties directors to have participated in the creation of the Second SLC or the selection of its members.

The absence of "fairness" to the FOA in connection with the Second SLC Resolution is further indicated by Mr. Sells' "reintroduction" in paragraph 4 of the Resolution of a restriction on who the Second SLC could engage as counsel. In particular, Mr. Sells included in the

[52] While Mr. Reichenbach is free to vote as he sees fit as a member of the Board, subject to his fiduciary duties to FOA, he identified only two instances, both of which involved decisions to terminate staff, where he had either abstained or voted against a position supported by Mr. Sells.

Second SLC resolution a provision that prohibited the Second SLC from engaging any counsel that had represented any party to the Litigation at any time between July 1, 2006 and June 15, 2012. This provision had the effect of barring the Second SLC from engaging Reed Smith or LeClairRyan. As with the nearly identical restriction imposed on the First SLC, whether or not the Second SLC wanted to employ Reed Smith or LeClairRyan is irrelevant – it is inherently unfair for one side of litigation to block the other side's selection of counsel, except in connection with a conflict of interest under applicable legal ethics rules of practice.

For the same reasons discussed above in connection with creation of the First SLC, the Examiner concludes that Article VII, Section 2 of the FOA By-Laws, addressing "common or interested" directors, did not permit the votes of the interested Gordon Properties directors to be counted in connection with approval of the Second SLC Resolution. Accordingly, the Examiner concludes that the adoption of the Second SLC Resolution by counting the votes of the Gordon Properties directors violated Va. Code § 13.1-871 and was an *ultra vires* action.

(b) The Second SLC Was Not Comprised Solely of Directors in Violation of the Virginia Code.

As with the First SLC, the Board's creation of the Second SLC failed to satisfy the requirements of Va. Code § 13.1-869. The Second SLC was comprised of two Board members (Ms. Hernandez and Mr. Reichenbach) and one non- Board member (Ms. Brungart). Ms. Brungart was a voting member of the Second SLC, and her vote, plus the vote of only one other of the two director-members, was sufficient to bind the Second SLC. That a non-director comprised one-third of the Second SLC was particularly problematic because the Second SLC Resolution delegated to the Second SLC *carte blanche* authority over the financial assets of

FOA, including the authority to settle the Litigation by the payment of substantial sums of FOA money to the Gordon Properties Entities.[53]

Had the Board desired to create a Second SLC comprised solely of three disinterested directors, it could have done so. In this regard, the Second SLC Resolution states in Recital D that Gordon Properties has a pending lawsuit against "[o]ne or more members of FOA's current Board of Directors…." The import of this recital appears to be that the Gordon Properties lawsuit rendered Ms. Hadley as interested or otherwise unsuitable for membership on the Second SLC, thus leaving Ms. Hernandez, Mr. Halls, and Mr. Reichenbach as the disinterested directors eligible to sit on the Second SLC. The Examiner does not agree that Ms. Hadley was interested or otherwise not a proper member of a special litigation committee. Thus, even after Mr. Halls declined to serve on the Second SLC, three Board members were eligible to serve on the Second SLC. The Board nonetheless chose to pass over Ms. Hadley and place Ms. Brungart, a non-director, on the Second SLC.

As a preliminary matter, there was no requirement that the Board create a special litigation committee in the first place. Instead, the Gordon Properties affiliated directors could have recused themselves from all matters relating to the Litigation (as defined in the First and Second SLC Resolutions) and left FOA's management of the Litigation to the disinterested directors. Mr. Sells appears to be the driving force behind the Board's decision to create both SLCs.

Va. Code § 13.1-869(A) requires that a committee of a board of directors have at least two members. That a Board committee required only two members raises the question of whether the Second SLC was appropriately populated (notwithstanding the membership of non-director Ms. Brungart) because the Second SLC still had two director-members. This question is

[53] As noted above, the Second SLC agreed to the payment by FOA of $377,000 to Gordon Properties.

pertinent in connection with the Second SLC's approval of the Settlement Agreement, because both director-members (and Ms. Brungart) voted to approve that Agreement (notwithstanding that Ms. Hernandez has subsequently come to oppose the Settlement Agreement). Nonetheless, Ms. Brungart's participation, as one of only three members of the Second SLC, necessarily influenced its deliberations and decision-making.[54] Accordingly, the Examiner concludes that Ms. Brungart's membership on the Second SLC undermined the process by which the Second SLC exercised the authority delegated to it in negotiating and agreeing to the terms of the Settlement Agreement.

Like Recital G of the First SLC Resolution, Recital G of the Second SLC Resolution referred to Article VI, Section 4 of the By-Laws, which empowers the president of FOA to create committees from among the FOA membership. This provision is just as irrelevant to the Second SLC as it was to the First SLC – both SLCs were creations of the Board, not of the president of FOA, even if it was Mr. Sells as president who drafted the resolutions adopted by the Board.

The minutes of the Board's regular meeting on April 16, 2013, reflect that:

> Mr. Sells moved that the Board of Directors ratify the appointment of Jane Brungart, Maria Hernandez, and Bill Reichenbach to the Special Litigation Committee.

The minutes further reflect that:

> President Sells noted that this is a relatively pro forma action on the part of the Board in that it appeared the original appointment of this group last October may not have been fully operative and needs to be reaffirmed.

The motion passed 7 to 0.

[54] By way of example, if Ms. Brungart and Mr. Reichenbach made it known to Ms. Hernandez that they favored a position (and constituted a majority vote), that could have influenced Ms. Hernandez to make the vote unanimous. This example applies to all other permutations of the three members of the Second SLC.

For the reasons stated above, the Examiner concludes that the Board's ratification of the membership of the Second SLC was inconsistent with Va. Code § 13.1-869 because it sought to ratify Ms. Brungart's participation on the Second SLC. [55]

In light of the foregoing, the Examiner concludes that the Board improperly delegated its authority to settle the Litigation to a committee that included a non-director as one of its three members and that creation of the Second SLC was an *ultra vires* act under Va. Code § 13.1-869.[56]

Because the creation of the Second SLC was an *ultra vires* act under the Virginia Code and because the adoption of the Second SLC Resolution violated the conflicts of interests provisions of the Virginia Nonstock Corporations Act, the Examiner concludes that the Second SLC was neither properly created nor populated.

3. Recommendation as to the Disposition of the Settlement Agreement

Because the Second SLC, like the First SLC, was neither created by a vote of the disinterested directors of the Board, nor populated solely by Board members, the Settlement

[55] The Examiner is aware that on April 30, 2013, the Debtors advised the Bankruptcy Court that "the evidence will establish that FOA's board voted unanimously (7-0) at a recent meeting to ratify the earlier appointment of the SLC and its approval of the settlement agreement." Memorandum in Support of Motion to Reconsider Order Appointing *Amicus Curiae*, p. 8 [Dkt. No. 576]. The Debtors explained in a corresponding footnote, "Notwithstanding that the parties believe the Court would conclude that the original appointment of the SLC following the 2012 election satisfied all applicable legal requirements, in light of the allegations contained in the *Sobol* complaint [Adv. Proc. No. 12-1562-RGM], FOA's board acted prophylactically to ratify the appointment and the actions of the SLC with respect to the settlement agreement in order to remove any doubt." The Examiner disagrees with the Debtors' interpretation of the scope of the Board's April 16 vote. In light of Mr. Sell's comments at the April 16, 2013 Board meeting that the motion addressed only a "relatively pro forma action," and the language of the motion itself in the minutes of the meeting, the Examiner interprets the scope of the Board's ratification to be limited to ratification of the selection of the members of the Second SLC, but not a ratification of all actions of the Second SLC including its approval of the Settlement Agreement.

[56] As discussed above in connection with the non-director members of the First SLC, Va. Code § 13.1-870.1 contains limitations on the liability of a corporation's officers and directors. Ms. Brungart, who was neither an officer nor a director of FOA, had no protection under Va. Code § 13.1-870.1. Likewise, Article VII, Section 1 of the By-Laws provides FOA directors and officers with indemnification rights under certain circumstances. That Ms. Brungart was protected by neither the limitation of liability provisions of the Virginia Nonstock Corporation Act nor the By-Laws makes her selection to, and participation in, the Second SLC inappropriate, especially in a case where Gordon Properties, a counter-party to the negotiations, had already sued a number of former Board members and officers. The absence of the limitations of liability and indemnity rights enjoyed by the director-members of the Second SLC may have chilled or otherwise influenced Ms. Brungart's actions vis-à-vis the Second SLC's negotiations with the Gordon Properties Entities.

Agreement it negotiated and approved was misbegotten and should not, without further FOA action, be approved by the Bankruptcy Court.

The Examiner is, however, mindful that the Second SLC appears to have worked hard and taken its responsibilities seriously in negotiating the terms of the Settlement Agreement which, itself, appears to represent a serious effort by the parties to resolve a raft of uncertain and expensive controversies. Likewise, the Examiner is mindful that the consensual resolution on fair terms of *all* of the litigation and the Arbitration between FOA and the Gordon Properties Entities would be in the best interests of FOA, the Debtors, and the Debtors' creditors. The Examiner emphasizes "all" because the Settlement Agreement, in its current form, leaves the door ajar to substantial future conflict on issues that have been the subject of litigation between the parties.[57]

Notwithstanding its problematic genesis described above, the Examiner is aware of no provision of the Virginia Nonstock Corporation Act or the By-Laws that would bar ratification of the Settlement Agreement, or a revised version thereof, by a majority of the disinterested directors of the Board. Thus, while there are certain problematic provisions of the Settlement Agreement, discussed below, the issues of fairness to the FOA and the actions of interested directors would be substantially resolved if a majority of the disinterested directors of the Board approved the Settlement Agreement or a modified version thereof. Accordingly, the Examiner recommends that the Bankruptcy Court advise the Debtors and FOA that a pre-condition to

[57] There is nothing inherently wrong with settling some disputes and continuing to litigate others. Nonetheless, the Examiner questions whether it is in the best interest of the Debtors not to resolve all pending disputes between them, FOA and the Board members. In particular, the Debtors recently expressed concerns to the Bankruptcy Court regarding their solvency and liquidity. If the Debtors are facing financial difficulties (which obviously would impact their ability to pay creditors under a plan of reorganization or otherwise), then a ***comprehensive*** settlement with FOA and the Board members, on fair terms, would appear to be in the Debtors' best interest.

Court approval of any settlement agreement is that it has been ratified by a vote of a majority of the disinterested directors of the Board.

4. Problematic Provisions of the Settlement Agreement

(a) The Condition Precedent that the Bankruptcy Court Vacate its Amended Board Order

Paragraph 5 of the Settlement Agreement provides that the Parties shall request that the Bankruptcy Court vacate its order of July 23, 2012 [Adv. Dkt. No. 239] (previously defined in this Report as the Amended Board Order). In addition, paragraph 5 states that "[t]he agreements herein of the Gordon Properties Parties are conditioned upon this order being vacated." [58]

Representatives of both the First and Second SLCs report that the Debtors' demand for *vacatur* of the Amended Board Order was of intense concern to the SLCs because Gordon Properties and Gordon Residential had run multiple candidates for Board seats in the October 2011 election. The SLCs' obvious concern was that without the rule set forth in the Amended Board Order, the Gordon Properties Entities might be able to use their substantial voting power to elect a Board comprised solely of Gordon Properties and/or Gordon Residential directors.[59]

The Examiner does not construe his investigative and reporting role as including extensive analysis of case law or the drafting of a legal brief. Nonetheless, the Examiner respectfully suggests to the Bankruptcy Court that *vacatur* of the Amended Board Order does not satisfy the

[58] The entire text of Paragraph 5 is as follows: "Upon entry of an order of the Bankruptcy Court approving this Settlement Agreement, the Parties shall withdraw all pending appeals and dismiss all pending litigation, with prejudice. In addition, in the 9019 Motion, the Parties shall request that the Bankruptcy Court vacate its order of July 23, 2012 [Dkt. No. 239]. The agreements herein of the Gordon Properties Parties are conditioned upon this order being vacated. Vacating the Order shall not, however, affect the term of any current member of the board of directors of FOA, who may continue to serve the balance of their terms in accordance with applicable law. Nothing in this settlement, however, shall prejudice any member of FOA from contesting in an appropriate forum in the future the qualification of any particular individual to sit on the Board."

[59] The Gordon Properties Entities' continuing interest in seating more than one director per entity was underscored by Mr. Howland's candidacy, as a representative of Gordon Residential, for a Board seat in the October 3, 2012 Board election. Mr. Howland, who was removed from the Board by virtue of the Bankruptcy Court's ruling in the Amended Board Order, received the second highest number of votes (presumably with the support of the Gordon Properties Entities). Mr. Howland ran for a Board seat notwithstanding that under the Amended Board Order (which the Debtors have appealed to the U.S. District Court), he was ineligible to sit on the Board as a representative of Gordon Residential, which already held a Board seat.

standards for *vacatur* of a final order or judgment to facilitate settlement, as identified and analyzed by Judge T.S. Ellis in *Neumann v. Prudential Ins. Co. of America,* 398 F.Supp.2d 489 (E.D. Va. 2005), the U.S. Court of Appeals for the Fourth Circuit in *Valero Terrestrial Corp. v. Paige,* 211 F.3d 112 (4th Cir.2000), and the U.S. Supreme Court in *U.S. Bancorp Mort. Co. v. Bonner Mall Partnership,* 513 U.S. 18 (1994). In particular, neither the Settlement Agreement, nor the joint motion to approve the Settlement Agreement [Dkt. No. 498], suggests that *vacatur* is called for by extraordinary circumstances or is in the public interest. To the contrary, the purpose of *vacatur* of the Amended Board Order appears solely to be the private interest of the Gordon Properties Entities to run multiple candidates for Board sets or, at a minimum, to have the opportunity to re-litigate the one-entity/one-board-seat issue that Gordon Properties litigated and lost before the Bankruptcy Court.

There is no apparent public interest in *vacatur*. Neither the public in general, nor FOA, nor the creditors of the Debtors will benefit from *vacatur*, which is more likely to result in future conflict than to end roughly seven years of hostilities. Finality as to this long-standing corporate governance issue is in the best interests of the Debtors, FOA, and the Debtors' creditors. *Vacatur* invites and perhaps even encourages the parties to commence new litigation as early as the October 2013 elections.

Finally, as suggested by the above-cited decisions, if the Gordon Properties Entities are aggrieved as to the Bankruptcy Court's ruling, their appropriate recourse is to appeal the Amended Board Order or to campaign to have the members of FOA vote to amend the By-Laws to permit an artificial entity to hold more than one seat on the Board at the same time.[60] In light

[60] The Debtors have perfected an appeal of the Amended Board Order, which is pending before the U.S. District Court as Case No. 1:12CV-01051-TSE. The pendency of the appeal gives rise to the question of whether the Bankruptcy Court has authority to vacate the Amended Board Order, or whether it could only be vacated by the District Court or by the Bankruptcy Court after remand. *See Levin v. Alms and Associates, Inc.*, 634 F.3d 260, 263 (4th Cir.2011) ("As a general rule, the filing of an appeal 'confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in

of the foregoing, the Examiner respectfully recommends to the Court that it advise the parties that the Court declines any request for *vacatur* of the Amended Board Order.

(b) The Permanent Maximum Assessment on the Restaurant Street-Front Unit

Paragraph 11 of the Settlement Agreement provides that the annual assessment against the Gordon Properties' restaurant Street-Front Unit shall never exceed $30,000 (the "Assessment Cap"), notwithstanding any sale or transfer by Gordon Properties of its interest in the Street-Front Unit, provided, however, that the Assessment Cap may be exceeded in any given year with the prior written consent of Gordon Properties or a subsequent owner, which consent shall not be unreasonably withheld.[61]

This provision creates a special assessment rule for the Street-Front Unit that appears to violate the requirement of Article IX, Section 1 of the By-Laws that assessments be based on the percentages of responsibility set forth in Exhibit D to the Declaration of the Forty Six Hundred Condominium (the "Declaration"). No provision in the By-Laws specifically authorizes the Board to limit assessments or otherwise deviate from the percentages of responsibility set forth in Exhibit D to the Declaration. Likewise, § 55-79.83 of the Virginia Condominium Act provides that common expenses shall be assessed against the unit to which the common expense was assigned (or divided among all such units, if more than one). Subsection (F) prohibits exemptions from assessments based on ownership: "It remains the policy of this section that neither a unit owned by the declarant nor any other unit may be exempted from assessments made pursuant to this section by reason of the identity of the unit owner thereof."

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the appeal'.")(*citing Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58, (1982)); *see also Lichtin/Wade, L.L.C.*, 486 B.R. 665, 670-71 (Bankr. E.D.N.C. 2013).

[61] The annual assessment against the Street-Front Unit under the FOA's 2013 budget is $18,704, well below the $30,000 Assessment Cap. Nonetheless, students of not-so-distant history will recall the inflation afflicting the U.S. economy in the 1970s. Looking back further, history is replete with periods of high inflation. While a $30,000 Assessment Cap may appear to leave a significant cushion today, forever is a very long time.

Given the foregoing, a *permanent* Assessment Cap that attaches to the Street-Front Unit, regardless of who owns the unit, appears to violate the By-Laws, Exhibit D of the Declaration, and the Virginia Condominium Act. A "cap" of limited duration (some reasonable number of years) might be justified as a settlement of litigation relating to the proper amount of the assessment. But to grant the Street-Front Unit a perpetual limitation of its assessment responsibility cannot be reconciled with the Condominium's governing documents or the Virginia Condominium Act.

The Examiner suggests that the proviso that the owner of the Street-Front Unit not withhold its reasonable consent to an assessment exceeding the Assessment Cap is insufficient to validate a provision unavailable to any other unit owner and that otherwise violates the By-Laws, the Declaration, and statutory law. Virginia law and the Condominium documents do not allow for a unit owner to be exempt from assessments (or from assessments in excess of a certain threshold). Requiring FOA to obtain consent if the threshold is exceeded will lead to future litigation, if consent is withheld and the parties have to litigate whether a particular unit owner's refusal to consent is reasonable.

In light of the foregoing, the Examiner respectfully recommends to the Court that it advise the parties that it will not approve a settlement agreement that fails to place a temporal limit on any Assessment Cap relating to the Street-Front Unit and that any Assessment Cap ends at such time as the Street-Front Unit is conveyed to a third party.

(c) The Cap on Any Special Charge against Units Owned by Gordon Properties, Gordon Residential, and Bryan Sells

Paragraph 12 of the Settlement Agreement prohibits FOA from imposing upon Gordon Properties, Gordon Residential, or Mr. Sells any user fee, assessment, or charge (other than normal assessments described in Paragraph 10) in an amount exceeding $200.00 per year without

the prior written consent of Gordon Properties, which consent shall not be unreasonably withheld.[62] This provision suffers from the same flaws as the provision creating the Assessment Cap for the Street-Front Unit. Placing a cap as to charges only on units owned by specifically named unit-owners (who might acquire additional units in the future which would presumably also be entitled to special treatment) appears to exceed the Board's authority, and conflict with the By-Laws, Exhibit D to the Declaration, and § 55-79.83 of the Virginia Condominium Act, which, among other things, prohibits exemptions from assessments based on the identity of a unit-owner. The Examiner also questions whether the By-Laws, the Declaration, and the Condominium Act permit FOA to make the imposition of fees and charges against the units of one owner (Gordon Residential or Mr. Sells) subject to the consent of a different unit owner (Gordon Properties).

In light of the foregoing, the Examiner respectfully recommends to the Court that it advise the parties that it will not approve a settlement agreement that fails (a) to place a reasonable temporal limit on any maximum charge to be assessed against a unit owned by Gordon Properties, Gordon Residential, and Mr. Sells; (b) to limit the cap to the units currently owned by Gordon Properties, Gordon Residential, and Mr. Sells; and (c) to provide that any cap ends at such time as a unit is conveyed by Gordon Properties, Gordon Residential, or Mr. Sells.

(d) The "Carve-Out" of Gordon Properties Claims against Former Board Members

The Settlement Agreement purports to include FOA's unit owners, officers, directors, SLC members, employees and agents. Nonetheless, Footnote 1 creates a "carve-out" from the Settlement Agreement, by which Gordon Properties does not release the Carve-Out Defendants

[62] Paragraph 12 refers to charges imposed upon Gordon Properties, Gordon Residential, or Mr. Sells, as distinct from charges imposed against Condominium units owned by those entities. The Examiner presumes that it is the intent of the parties that paragraph 12 apply to charges imposed against the units owned by those entities rather than the entities themselves.

"from any claim that Gordon Properties may have against them for conduct engaged in by them during the time they served as officers or directors of FOA." As noted above in Footnote48, Gordon Properties sued the Carve-Out Defendants on October 7, 2011, alleging claims for fraud and breach of fiduciary duty, election fraud, and statutory business conspiracy, relating to FOA's 2009 and 2010 annual meetings and elections.

Gordon Properties took a voluntary nonsuit of its complaint against the Carve-Out Defendants on October 31, 2012, over nine months ago. Accordingly, the statute(s) of limitations may now have run as to some or all of Gordon Properties' claims, were it to re-file its complaint. Nonetheless, Gordon Properties has advised the Examiner through counsel that it takes no position on the applicable statute(s) of limitation.

Gordon Properties' refusal to agree to a release of the Carve-Out Defendants, and its decision to take no position on whether its claims are barred by applicable statutes of limitation, leaves open the prospect that (a) Gordon Properties could use the threat of re-filing the complaint as leverage in dealing with current and future members of the Board and (b) the Carve-Out Defendants will seek indemnification from FOA for their legal fees and costs incurred in defending against the Gordon Properties complaint if it is re-filed.

There is nothing inherently improper with refusing to release particular parties as part of a settlement. But given the history of litigation involving these parties, and that Gordon Properties actually sued the Carve-Out Defendants, the Examiner respectfully suggests that the Bankruptcy Court not approve the Settlement Agreement with the Carve-Out provision unless Gordon Properties takes a binding, unequivocal position on which claims, if any, against the Carve-Out Defendants it contends are not barred by the applicable statute of limitations and why such claims are not so barred. Without requiring Gordon Properties to either drop the Carve-Out or

take a position on the continued viability of its Carve-Out claims, neither FOA, nor the Court, nor the Debtors' creditors, can assess the likelihood that (a) the Settlement Agreement will bring an end to the costly litigation between Gordon Properties and the Board, (b) Gordon Properties could use the threat of renewed litigation against former Board members as leverage in dealing with future issues, and (c) FOA will be required to participate in future litigation by way of claims for indemnification from the Carve-Out Defendants.

(e) The Agreement that the 2013 Budget is the Template for Future FOA Budgets and Assessment Calculations

Given the past animosity and litigation between the Debtors and FOA, it is important that the Settlement Agreement be a model of clarity to limit the prospect of future legal fights. The last sentence of paragraph 10 of the Settlement Agreement provides that "Furthermore, FOA's 2013 budget shall be adopted by FOA as the template for future budgets and assessment calculations." A copy of the FOA 2013 budget is part of the Settlement Agreement as Exhibit A.The last sentence of paragraph 10 lacks clarity and could easily become the source of future litigation.

For example,[63] at the Board's September 18, 2012 regular meeting, Mr. Sells moved to have the Board direct FOA's Budget and Finance Committee and FOA management to construct the 2013 budget "so that it reflects an equalization of fees for common element storage at zero." This resolution (the "Storage Area Resolution") passed 4 to 1 to 1, with the three Gordon Properties directors (Mr. Sells, Ms. Wilson, and Ms. Greenwell), together with Ms. Moore, in favor; Ms. Hadley opposed; and Mr. Pepper abstaining.

Gordon Properties is the owner of Unit 331. In pre-bankruptcy litigation between Gordon Properties and FOA, the Circuit Court found that Gordon Properties, as the owner of Unit 331, was responsible under Va. Code § 55-79.83(B), for assessments relating to Storage Area Limited

[63] The following discussion is offered as merely one example of uncertainty as to the scope and operative effect of the last sentence of Paragraph 10 of the Settlement Agreement.

Common Elements (single user) 1B1, 1B2, 1C1, 2B1, 2B2, and 2C1, which are all appurtenant to Unit 331. *See* paragraph 4, Circuit Court Letter Opinion of February 23, 2009, Civil Case CL08-001432, and section B(2) Circuit Court Letter Opinion of April 3, 2009, Civil Case CL08-001432.

The FOA 2012 budget reflected Storage Area assessments of $21,852. The FOA 2013 budget suggests that Unit 331 was responsible for a very substantial percentage of the Storage Area assessments. The operative effect of the Storage Area Resolution was to reduce the Storage Area assessments, including the assessments previously paid by Gordon Properties, to zero. It is unclear whether the last sentence of paragraph 10 is intended to prohibit FOA in future years from adjusting the Storage Area assessments to a figure above zero, or whether the parties are only agreeing that the 2013 budget accurately reflects assessment categories and percentages, but that a future Board could restore Storage Area assessments to a future budget. The Examiner respectfully recommends that the Bankruptcy Court require that FOA and Gordon Properties unequivocally state their understanding as to the scope and operative effect of the last sentence of paragraph 10 as a condition to the Court's approval of the Settlement Agreement.

(f) The Requirement that FOA Vote for a Future Gordon Properties or CSI Plan of Reorganization

Paragraph 13 of the Settlement Agreement commits FOA to not object to, and to vote to accept, any plan of reorganization proposed by either Gordon Properties or CSI, provided that such plan "does not adversely modify the terms of this Settlement Agreement." The Examiner questions whether, in light of the postpetition disclosure and solicitation requirements of 11 U.S.C. § 1125(a) and (b), FOA and the Debtors can properly enter into an agreement by which FOA commits to vote for a plan, the terms of which are completely unknown. *See, e.g., In re Indianapolis Downs, LLC,* 486 B.R. 286, 295-96 (Bankr. D. Del. 2013). This provision may be

moot in that, should the Bankruptcy Court approve the Settlement Agreement as submitted, all FOA claims against Gordon Properties and CSI will be extinguished, leaving FOA with no right to vote to accept or reject a Gordon Properties or CSI plan. Nonetheless, so long as FOA retains the right to vote on a Gordon Properties or CSI plan, the Examiner respectfully recommends that the Court decline to approve a settlement agreement provision that requires FOA to vote to accept such a plan without full, prior disclosure of such plan's provisions as required by 11 U.S.C. § 1125.

IV. Closing

This Report summarizes the Examiner's investigation and sets forth his conclusions and recommendations. With the submission of this Report, the Examiner respectfully submits that he has completed the duties and obligations assigned to him by the Bankruptcy Court and the Office of the United States Trustee. The Examiner is prepared to address, at the Court's convenience, any questions, comments, or concerns the Court may have.

Dated: August 8, 2013

Respectfully submitted,

/s/ Stephen E. Leach
Stephen E. Leach, Examiner