GANFER SHORE LEEDS & ZAUDERER LLP

CLIENT ADVISORY

MAY 2021

SHAREHOLDER'S ACTION ASSERTING THAT BOARD AND MANAGING AGENT FAILED TO KEEP BUILDING EXTERIOR IN PROPER REPAIR IS DISMISSED

A lawsuit by a tenant-shareholder in a Cooperative alleging that the Board of Directors and managing agent failed to keep the exterior of the building in proper repair was dismissed under the Business Judgment Rule. **Weinstein v. Board of Directors of 12282 Owners' Corp., 2021 N.Y. Misc. LEXIS 1840, 2021 N.Y. Slip Op. 50338(U) (Sup. Ct. N.Y. Co. Apr. 19, 2021)**.

The lawsuit was based on paragraph 2 of the proprietary lease between the Cooperative and the plaintiff, which requires the Cooperative to keep the building in good repair at its expense. Plaintiff alleged that in 2010, the Board of Directors became aware of a crack in the building's façade. The Board addressed this problem by hiring a contractor who undertook to caulk the crack every five years, while rejecting the view of other engineers that "extensive brick work to close up the crack" was required. In 2018, the Cooperative's architect found that the façade had sustained substantive damage due to improper installation of air conditioning sleeves in 1984. The Board then announced that to address these problems, it would undertake a significant repair project, which would cost $980,000 and be financed in part with an assessment.

Plaintiff wrote to the Board asserting that the Cooperative's managing agent, rather than the shareholders, should bear the costs of the façade repairs because the managing agent had failed to ensure that the façade was properly inspected and repaired. Plaintiff submitted a formal shareholder demand that the Board sue the managing agent. Plaintiff subsequently filed this action against the Board and the managing agent, asserting both derivative claims on behalf of the Cooperative and individual claims on his own behalf.

In its decision dismissing the complaint, the court addressed several procedural issues. First, the court concluded that plaintiff should have joined his wife, with whom he co-owns his cooperative shares, as a plaintiff because the outcome of the lawsuit could affect her interests. However, if the complaint were otherwise viable, this deficiency could be cured by amendment. Second, the court addressed a requirement contained in Section 45 of this proprietary lease that a shareholder may not commence certain types of litigation against the Cooperative without first providing written notice. The court found that Section 45 was ambiguous as applied in this case and therefore declined to dismiss the action on that basis. Third, the court found that plaintiff had made a sufficient pre-suit demand on the Board before bringing his derivative claims. Fourth, the court held that parts of the complaint were improperly pleaded because they intermingled derivative and direct (individual) claims without making clear which was which.

On the merits, the court dismissed plaintiff's claim against the Board for breach of fiduciary duty under the Business Judgment Rule. While plaintiff alleged that the Board had mismanaged the façade crack issue by failing to competently retain or oversee contractors to address the problem, "allegations merely of mismanagement are not enough." Rather, 'absent a showing of discrimination, self-dealing, or misconduct' by the Board or its members, 'judicial inquiry into the actions of corporate directors is prohibited' – even if 'the results show that what [Board members] did was unwise or inexpedient.'" Plaintiff also alleged, "upon information and belief," that the Board failed to act sooner because imposing a large assessment might result in the directors being voted off the Board. This did not change the result because plaintiff did not provide particulars of any self-interested conduct by the Board or specify the sources of his information and belief.

360 Lexington Avenue, New York, New York 10017 Tel: (212) 922-9250 Fax: (212) 922-9335 http://www.ganfershore.com

The court also dismissed the claims against the managing agent. The court rejected the argument that the managing agent's actions were also protected by the Business Judgment Rule, stating that this rule was developed to protect boards and board members, not third-party agents. However, the Board's own decisions remained protected, and one of those decisions was not to sue the managing agent. Thus, "even if [the managing agent] is not itself covered by the business-judgment rule, permitting plaintiff's derivative claims against [it] to go forward would impermissibly circumvent that rule as it protects the decisions of the Board."

CONDO BOARD MAY BE LIABLE FOR TORTIOUS INTERFERENCE FOR REFUSING TO CONFIRM IT WILL NOT EXERCISE RIGHT OF FIRST REFUSAL

When a condominium board of managers declines to exercise its right of first refusal, but refuses to provide written confirmation of its decision when asked to do so, it may be liable for tortious interference with the would-be purchaser's contract. **Tumayeva v. Ocean Condominium No. Two**, **2021 N.Y. Misc. LEXIS 490, 2021 N.Y. Slip Op. 30368(U) (Sup. Ct. Kings Co. Feb. 5, 2021)**.

Plaintiff signed a contract to acquire a unit in the Condominium. As in most condominiums, the By-Laws afford the Board of Managers a right of first refusal over any transfers of units. This means that the Board may prevent a would-be purchaser from acquiring the unit if the Board agrees to purchase the unit from the seller for the same price. However, unlike in a cooperative, a condominium board generally cannot disapprove a purchase application unless it is prepared to pay to acquire the unit itself, which rarely occurs.

Plaintiff asserted that she has young children and that the President of the Board of Managers, who owns the apartment below the one she sought to buy, did not want children living above him. Plaintiff also asserted that the Board did not want to see a sale in the building at the relatively low price she had negotiated. According to plaintiff, the Board did not exercise its right of first refusal, but "they would not provide the document which this development ordinarily provides, stating that they were not exercising their right of first refusal," even though providing such a document "is apparently the custom and practice in this development." Plaintiff further alleged that without this document, the bank that had provided plaintiff's mortgage commitment refused to close, and therefore she was unable to acquire the unit, which was ultimately foreclosed on by a lienholder. Based on these allegations, the court held that plaintiff had stated a cause of action against the Board of Managers for tortious interference with her purchase contract.

However, the court dismissed several other claims the plaintiff had sought to assert based on the same facts. Plaintiff could not assert a claim against the Board for breach of the Condominium's By-Laws, because the By-Laws do not apply to prospective purchasers who do not yet have a relationship with the Condominium. Plaintiff's cause of action against the Board for breach of fiduciary duty was dismissed for the same reason. The court also dismissed plaintiff's attempt to plead a claim for breach of contract based upon a processing fee she had paid to the Condominium to review her request to purchaser the unit. The court found that plaintiff had no contractual relationship with the Condominium, and that the selling unit owner was the party that asked the Board to review the contract, even though the seller had asked the purchaser to pay the application fee.

The court also dismissed the claims against the individual board members. Finally, the court held that "[a]n action against an unincorporated association (which is what a condominium is in New York) must be maintained against its president or treasurer." Citing the New York General Associations Law, the court required the purchaser to amend its complaint to name the president or treasurer, in a representative capacity, as the defendant. Although the same judge gave the same direction in a prior decision (see the September 2020 issue of this *Client Advisory*), this is not how actions involving condominiums are typically captioned and this holding may not be followed by other courts. In any event, the court held that this was not a jurisdictional issue and that the caption could be amended to cure the alleged defect.