
CLIENT ADVISORY

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BY-LAW PROVISIONS REQUIRING "REASONABLE" ACTION CAN RESTRICT BOARD DISCRETION AND LEAD TO LITIGATION

Decisions of New York cooperative and condominium boards are generally protected by the "business judgment rule," which creates a presumption that such decisions are valid. However, many buildings' by-laws, proprietary leases, and other governing documents require that board actions must be "reasonable." For example, a by-law or lease provision may allow the board to promulgate "reasonable" house rules or provide that the board must not "unreasonably withhold" permission to sublet. Such uses of the word "reasonable" may appear innocuous, because no one would contend that boards should act unreasonably. Nonetheless, the use of qualifiers such as "reasonable" can significantly restrict a board's ability to make decisions without being second-guessed in litigation.

The Appellate Division, First Department, recently reinforced this lesson in **Braun v. 941 Park Ave., Inc.**, 816 N.Y.S.2d 58 (1st Dep't June 6, 2006). The case involved the validity of a special House Rule adopted by a cooperative board to resolve a complicated dispute concerning two shareholders' use of a common vestibule area. The Appellate Division observed that "the cooperative's governing documents require that its House Rules . . . be 'reasonable,' and as such, must be reviewed under a standard of reasonableness, rather than the business judgment rule ordinarily applicable to cooperative board actions." Moreover, the court noted that the law is unclear regarding precisely what types of language in proprietary leases would be sufficient to override the "business judgment rule," particularly in leases drafted prior to 1990, when the New York State Court of Appeals' Levandusky decision applied the "business judgment rule" to cooperatives.

Applying the "reasonableness" standard, a majority of the court struck down part of the House Rule as unreasonable, although other portions of the rule were found to be reasonable and valid. Two dissenting justices voted to strike down the entire House Rule as unreasonable. It is not clear whether the result would have been different had the House Rule been subject to judicial review only under the "business judgment rule," but this case strongly suggests that, if a cooperative or condominium wishes its Board to have the widest discretion to make decisions without being subject to judicial second guessing, qualifications such as "reasonable" should not be used in proprietary lease or by-laws provisions.

BY-LAW PROVISIONS GOVERN BOARD MEMBERSHIP ELIGIBILITY, INSPECTION OF VOTING RECORDS

Another appellate case emphasizing the importance of carefully worded cooperative by-laws is **Schapira v. Grunberg**, 2002 WL 1766560, 2006 N.Y. Slip Op. 5204 (1st Dep't June 29, 2006). This case involved two issues, the first of which concerned eligibility to serve on the board of directors. The court rejected the plaintiffs' contention that only shareholders were allowed to be directors, holding that "[t]he bylaw pertaining to qualifications for those serving on the Board of Directors does not limit Board membership to shareholders Had the authors of the bylaws intended that only shareholders serve as directors this could easily have been included in the exclusive list of qualifications for board membership." Plaintiffs contended that a by-law provision that "a director who ceases to be a shareholder . . . shall be deemed to have resigned as a director" created an implicit requirement that the directors must be shareholders, but the court disagreed.

The second issue in the case concerned three directors' demand to inspect the election records. The court held that the inspection should have been allowed, because "[a]lthough corporate counsel announced at the election that the voting would proceed by secret ballot, this is not provided for in the bylaws and did not negate the provisions in the bylaws for inspection of corporate records." This decision implies that if a cooperative or condominium wishes shareholder votes to be secret and not subject to inspection, the by-laws should specifically provide to that effect.

APPELLATE DIVISION ORDERS FURTHER SANCTIONS FOR FRIVOLOUS REAL ESTATE LITIGATION, NOTICE OF PENDENCY

In Yenom Corp. v. 155 Wooster Street, Inc., 23 A.D.3d 259 (1st Dep't 2005) (discussed in the December 2005 issue of this Client Advisory), the Appellate Division affirmed dismissal of a claim for specific performance of a contract to purchase stock in a corporation whose sole asset was real property, finding that no enforceable contract of sale was ever entered into and the proposed transaction was governed by the statute of frauds requiring that any such contract must be in writing. The court also affirmed an award of sanctions against the plaintiff and its counsel, in the form of attorneys' fees and expenses, because the action and a Notice of Pendency filed against the property were frivolous. In February 2006, the Court of Appeals denied leave to appeal.

The Appellate Division has now entered a second opinion in this case, awarding additional sanctions against the plaintiff and its counsel to reimburse defendants for their attorneys' fees and expenses incurred in the appellate proceedings, on the ground that plaintiff's appeal from the trial judge's dismissal of its case was also frivolous. Yenom Corp. v. 155 Wooster Street, Inc., 2006 WL 1914584, 2006 N.Y. Slip Op. 5732 (1st Dep't July 13, 2006). The lengthy opinion received front-page coverage in The New York Law Journal the day after its release. Ganfer & Shore, LLP represented several of the defendants in this case.

LEGISLATURE FURTHER REVISES LLC PUBLICATION REQUIREMENTS

The publication requirements for limited liability companies (LLC's) and other non-corporate business entities – including domestic New York entities and out-of-state entities authorized to do business in New York – have been revised again, effective June 1, 2006. Some of the burdensome requirements of previous legislation, such as that the published notice include a list of the LLC's owners, have been deleted, but others have been retained. Entities created after January 1, 1999 that have not already satisfied the publication requirement have until May 31, 2007 to do so.

Although this publication requirement may appear "technical," penalties for failure to satisfy it include automatic suspension of an entity's authority to operate in New York until the publication process is completed and an affidavit of publication is filed with the Secretary of State. This could mean that the entity would be unable to commence litigation if it needed to do so. Additionally, in at least one recent situation, a lender contended that a borrower's failure to maintain its status as an LLC in good standing placed the loan in default so that interest was payable at the default rate. To avoid any such problems, owners of LLC's, LLP's, and similar business entities should check with counsel to ensure that all of their filing requirements have been satisfied.