
CLIENT ADVISORY

APRIL 2009

CONDOMINIUM PURCHASER MAY NOT SUE SPONSOR FOR OMISSIONS FROM OFFERING PLAN, HIGH COURT HOLDS

An issue frequently litigated in New York courts is whether, and under what circumstances, purchasers of cooperatives or condominiums may bring claims for fraud against sponsors or others involved in the offering process. Article 23-A of the New York General Business Law, commonly referred to as the Martin Act, requires that offering plans disclose material information to purchasers. The Attorney General of the State of New York is responsible for supervising compliance with this requirement and is empowered to sue violators. While it has long been recognized that there is no private right of action under the Martin Act or the Attorney General's regulations implementing it, court decisions have disagreed regarding whether private parties may assert common-law fraud claims based upon allegedly misleading or incomplete offering materials. (For discussion of prior cases on this subject, please see the November 2007 and May 2008 issues of this *Client Advisory*.)

In *Kerusa Co. LLC v. W10Z/515 Real Estate Limited Partnership*, 2009 WL 856327, 2009 N.Y. Slip Op. 2482 (N.Y. Apr. 2, 2009), New York's highest court, the Court of Appeals, addressed this issue. The Court's conclusion was that "a purchaser of a condominium apartment may not bring a claim for common-law fraud against the building's sponsor when the fraud is predicated solely on alleged material omissions from the offering plan amendments mandated by the Martin Act . . . and the Attorney General's implementing regulations."

This case arose from complaints by the purchaser of a condominium unit that construction and design defects in the building caused water damage, leading to leaks, system failures, and mold problems. The purchaser sued several parties on various causes of action, one of which was for allegedly false and fraudulent representations and material omissions from the defendants' offering materials. Among other things, the purchaser asserted that the sponsor knew of the construction and design defects, but fraudulently failed to disclose them in amendments to the offering plan that were filed as construction progressed. In particular, the sponsor had repeated in each amendment – as required by the Attorney General's regulations under the Martin Act – that except as specified in that amendment, "there have been no material changes of the facts or circumstances affecting the Property or the offering." The purchaser alleged that in each instance, this statement was fraudulent, because information about construction defects known to the sponsor had been omitted.

The Court of Appeals, reversing an Appellate Division decision, rejected the purchaser's claim. The Court began by discussing the history and purpose of the Martin Act, which conferred broad powers on the Attorney General to prevent fraudulent securities investment practices. The Attorney General's regulations, the Court noted, are extremely detailed and impose substantial disclosure obligations on sponsors that go well beyond the level of disclosure that would be required if the statute did not exist. The Court concluded that allowing a common-law fraud claim based on omissions from the legally required offering plan amendments "would invite a backdoor private cause of action to enforce the Martin Act in contradiction to [the rule] that no private right to enforce that statute exists." The opinion also expressed concern that allowing this theory of liability would invite litigation arising from failure to disclose ordinary, day-to-day issues that arise during

construction. Additionally, the Court noted that the purchaser's claim for "fraudulent concealment" of material facts was based on alleged failures to disclose those facts in the offering plan, rather than overt acts of covering up or concealing the facts. Once again, the Court concluded, a private fraud claim could not be based simply on these allegations of omissions from the required documents.

Significantly, the Court of Appeals' decision addressed only *omissions* from required disclosures in offering plans and their amendments. In a footnote, the court specifically noted that it was "not decid[ing] whether the alleged *misrepresentation* of an item of information that the Martin Act or the Attorney General's implementing regulations require to be disclosed would support a cause of action for fraud, so long as the elements of common-law fraud were present." (Emphasis added.) This issue, among others, is left for litigation in future cases.

COURT REFUSES TO DISMISS CONDOMINIUM OWNER'S CLAIMS THAT BOARD IMPROPERLY BLOCKED CONVERSION OF UNIT TO RESIDENTIAL USE

Claims by a condominium unit owner that the Board of Managers unlawfully prevented it from converting its unit to residential use were allowed to proceed to discovery in **30 CPS, LLC v. Board of Managers of Central Park South Medical Condominium**, 2009 WL 513458, 2009 N.Y. Slip Op. 29086 (Sup. Ct. N.Y. Co. Mar. 2, 2009). In this case, the owners of a penthouse condominium unit, which had previously been used as a restaurant, sought to alter and sell the unit for residential use. The Condominium was located in a residential zone, but use of the penthouse as a restaurant had been permitted pursuant to a variance and was provided for in the Certificate of Occupancy. The By-Laws of the Condominium, however, provided that the penthouse could be used for any legal purpose and that alterations would not require board approval.

The owner of the penthouse sought and obtained permits from city agencies to convert the penthouse to residential use, but the Condominium Board decided that it would not allow the penthouse to be used as a residence. The owners alleged that the Board's decision resulted from discrimination based on their national origin. They sued the Condominium and the Board President for breach of the By-Laws and for tortiously interfering with their rights. The court denied a motion to dismiss these claims. Because the By-Laws provided that the penthouse could be used for any legal purpose, and the building was located in a residential zone, the court found that it followed that residential use of the penthouse was permissible and that the Condominium could not interfere with that use. Moreover, the detailed allegations of national origin discrimination were sufficient to sustain the pleading of the tortious interference claim. The court upheld the pleading of the claim against the Board President individually, based on allegations that he had made offensive comments about the plaintiff's national origin, and observed that it was premature to consider dismissing this claim because files of e-mails between Board members were still in the process of being analyzed.

PURCHASER OF COOPERATIVE UNIT RECOVERS DOWN PAYMENT AFTER BOARD APPROVES PURCHASER BUT NOT HER DOG

In **Lovelace v. Krauss**, 2009 WL 824089, 2009 N.Y. Slip Op. 2454 (App. Div. 1st Dep't Mar. 31, 2009), the contract of sale for a residential cooperative unit provided, as is customary, that the transaction would be cancelled and the purchaser's down payment refunded if the Board of Directors disapproved the purchaser's application. The purchase contract identified the purchaser's dog as an occupant of the apartment. The Board approved plaintiff's purchase application, but its approval letter permitted the purchaser to have a dog present in her apartment only "on occasion." The court held that this did not constitute an unconditional approval of the purchaser's application, so that she was entitled to cancel the contract and recover her down payment.