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# CLIENT ADVISORY

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DECEMBER 2010

## **FORECLOSING LENDER ON COOPERATIVE APARTMENT MUST OBTAIN BOARD APPROVAL BEFORE ACQUIRING UNIT**

When a property owner fails to make payments on a cooperative loan, the lender's remedy is to foreclose on the unit and sell it at auction. What happens if the high bidder at the auction is unable to obtain the cooperative board's approval to acquire title? This question was recently addressed by the Appellate Division in **LI Equity Network, LLC v. Village in the Woods Owners Corp., 2010 WL 4118588, 2010 N.Y. Slip Op. 7514** (App. Div. 2d Dep't Oct. 19, 2010).

In this case, the tenant-shareholders of a cooperative unit stopped making payments on their cooperative loan. The bank declared the loan in default and scheduled an auction of the unit to be conducted under Article 9 of the Uniform Commercial Code. Plaintiff, a limited liability company (LLC), was the high bidder. Soon afterward, the bank advised plaintiff that the Cooperative's Board of Directors would not allow plaintiff to acquire title to the unit. The Board decided that it would not allow the plaintiff to close on the unit even for the purpose of immediately reselling it to a Board-approved purchaser. Plaintiff sued both the bank and the Cooperative and moved for specific performance of the contract of sale. A lower court granted the plaintiff's motion and ordered the Cooperative to allow the purchase to close.

The Appellate Division reversed this decision, holding that the plaintiff was subject to the requirement, contained in the Cooperative's governing documents, that all purchases required board approval. In reaching this conclusion, the court rejected plaintiff's argument that cooperative requirements cannot prevent a transfer of a unit that occurs by operation of law, such as through a foreclosure sale. Here, the terms of sale specifically provided that the unit was being sold subject to the Cooperative's by-laws, regulations, procedures, and offering plan, and plaintiff had agreed to comply with such terms of sale. While plaintiff contended that there was a conflict between the Cooperative's approval requirement and plaintiff's statutory rights under the UCC, the court found that there was no such conflict, because the UCC specifically allows a seller to impose terms of sale.

The court went on to add, however, that it would have reached the same result even if the terms of sale did not expressly incorporate the Cooperative's governing documents. It cited several prior decisions in which provisions of a proprietary lease, cooperative by-laws or other governing documents were held to govern even where a unit was transferred by operation of law, such as by UCC Article 9 sale or upon a tenant-shareholder's death. The court also emphasized that this was a non-judicial sale, so that there was no court order of foreclosure that could affect the legal analysis.

The court noted that the Cooperative had by-laws prohibiting ownership of units by corporations or other business entities. The by-laws also required all purchasers to occupy their units for at least one year after acquiring them. The court concluded that the Cooperative had exercised reasonable business judgment in rejecting plaintiff's application, including plaintiff's proposal to purchase the unit and immediately resell it.

**APARTMENT OWNERS HAVE NO CLAIM  
AGAINST BUILDING ENGINEER, COURT HOLDS**

The purchasers of a condominium apartment complained that their unit was too cold in winter and too hot in summer. They sued the mechanical engineering firm that designed the building's heating, ventilation, and air conditioning systems. The unit owners' negligent misrepresentation claim was dismissed by New York's highest court, the Court of Appeals, in **Sykes v. RFD Third Avenue 1 Assocs., LLC**, 15 N.Y.3d 370 (2010).

The Court observed that to prevail on a claim for negligent misrepresentation in New York, the plaintiff must show either that it was in "privity of contract" with the defendant, meaning that a contractual relationship existed between them, or alternatively, that their relationship was "so close as to approach that of privity." To establish a relationship "close to privity" requires, among other things, that the defendant must have been aware that its work would be relied on for a particular purpose and that a "known party or parties" was intended to rely upon it.

In this case, the Court held, the owners' claim failed because they did not sufficiently establish that they were a "known party or parties who would be relying on the engineer's work." Plaintiffs' negligent misrepresentation claim, like other claims that were dismissed earlier in the litigation, was based on statements contained in the offering plan. The Court acknowledged that the engineering firm "obviously knew in general that prospective purchasers would rely on the offering plan," but emphasized that "there is no indication that [the engineer] knew these plaintiffs would be among them, or indeed that [the engineer] knew or had the means of knowing of plaintiffs' existence when it made the statements for which it is being sued." Because the engineer had no information regarding the *specific* purchaser that might rely on its allegedly negligent statements about the HVAC system, the court held, it could not be liable for negligent misrepresentation.

**MARTIN ACT HELD NOT TO BAR COMMON-LAW TORT CLAIMS  
WHERE MISREPRESENTATIONS ARE MADE OUTSIDE OFFERING PLAN**

An issue frequently litigated in New York courts is whether, and under what circumstances, purchasers of cooperatives or condominiums may bring tort claims 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 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 tort claims arising from misrepresentations made to them during the offering process. (For discussion of prior cases on this subject, please see the November 2007, May 2008, and April 2009 issues of this *Client Advisory*.)

The most recent decision on this issue is the First Department's ruling in **Assured Guaranty (UK) Ltd. v. J.P. Morgan Investment Management Inc.**, 2010 WL 4721590, 2010 N.Y. Slip Op. 8644 (1st Dep't Nov. 23, 2010). In this decision, the Appellate Division reaffirmed the longstanding rule that there is no private right of action under the Martin Act itself, nor may a claim be "drafted in such a way as to cast what is clearly an obligation under the Martin Act as a common-law cause of action." On the other hand, the court held that the Martin Act does not preempt causes of action by private parties involving securities fraud in cases where the cause of action would exist independent of the Martin Act and does not rely exclusively on breaches of Martin Act obligations.