GANFER & SHORE, LLP

CLIENT ADVISORY

FEBRUARY 2003

On January 22, 2003, Ganfer & Shore, LLP hosted another successful session in our series of breakfast panel discussions addressing topics of significant interest to cooperatives, condominiums and real estate owners. The topic of the seminar was how to protect against discrimination claims in the applicant approval process. Ganfer & Shore, LLP would like to express its appreciation to the guest speakers: Aaron Goldstein, Esq., Assistant Vice President, New York Specialty Claims Manager, Chubb & Son; Anthony Angelico, Director of Operations, Goodstein Management; and Thomas A. Pasquazi, III, Executive Vice President/COO, Orsid Realty Corporation, and all those who attended.

EFFORTS TO PREVENT "TROUBLESOME" SHAREHOLDER FROM RUNNING FOR THE BOARD NOT PERMITTED

In **Feld v. 710 Park Avenue Corp. (NYLJ, 1/15/03, p. 19, col. 1)**, the plaintiff ("Plaintiff"), a former board member and past president of the Cooperative Corporation (the "Co-op"), announced his intention to run for a seat on the board of directors (the "Board") just 3 weeks before the date set for the election. Plaintiff's announcement was in a letter to shareholders which also accused the current board members of incompetence and self-dealing. One week later, the existing Board promulgated new amendments to the Co-op's by-laws to prevent him from running. The amendments provided, in pertinent part: (i) that no person may be a director unless they have a baccalaureate degree from a recognized college or university in the United States, or the equivalent degree from an educational institution outside of the United States; and (ii) that no person who has commenced an action against the Co-op, or against one or more of the board members who would be entitled to indemnification from the Co-op, and who has neither prevailed in that action, nor settled it, may be either an officer or director. The Plaintiff sued to overturn the amendments and, pending a final determination, to enjoin the Co-op from enforcing them.

The Co-op first took the position that the Plaintiff could not prevail because decisions of the Board are shielded from judicial scrutiny by the business judgment rule. (See our June 2002 newsletter). As we stressed in several of our prior newsletters, the business judgment rule does not protect a Board or its members from judicial scrutiny where evidence is submitted that there has been self-dealing or there has otherwise been a breach of board members' fiduciary duty to the Co-op. This Court held that Plaintiff's allegations of "invidious unequal treatment" of shareholders by the Board sufficed to overcome the shield of the business judgment rule.

The Plaintiff had claimed that the amendments were adopted specifically to prevent him from running for a position on the Board. The Co-op's President admitted that the provision barring certain persons who had litigated against the Co-op from running in the Co-op's election was promulgated as the result of a lawsuit that Plaintiff had previously brought against two former directors and the law firm representing the Co-op. There was no other shareholder to whom this exclusion applied. The President also claimed that he did not know that Plaintiff did not have a college degree, but Plaintiff had submitted a copy of a transcript of

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

testimony given by Plaintiff on behalf of the Co-op in an unrelated action in which his educational background was specifically discussed, and another current board member had been present at that deposition. Thus, based on both of these facts, the Court held that it was likely that Plaintiff would be able to prove that he was the target of these hastily adopted amendments. The Court enjoined the Co-op's enforcement of these new amendments pending a decision on the merits of Plaintiff's case.

$250 FINE FOR NOT KEEPING DOOR CLOSED HELD TO BE UNENFORCEABLE

The owner of a building located at 465 Seventh Avenue (the "Owner") had spent large sums of money to upgrade the building's facade and sought to maintain the facade's appearance by inserting a clause into its tenant's lease that required that the entrance door to the premises (a store) be kept closed at all times, and that, in the event that the tenant violated the lease provision, the Owner would have the right to charge $250 for each violation. The Owner claimed that the propping open of the tenant's entrance door detracted from the building's appearance materially affecting the Owner's ability to attract suitable tenants. Apparently, the Owner took the position that the tenant had violated the lease clause numerous times, including four times in one day. Ultimately, the Owner sued the tenant for $6,500 in charges related to violation of the lease clause, resulting in a non-payment action by the Owner against the tenant.

In **Arsenal Company LLC v. Fashions Collections of Seventh Avenue LLC,** (NYLJ, 1/15/03, p. 20, col. 1), Justice Karen Smith of the Commercial Housing Part of the New York City Civil Court, found the lease clause to be a penalty and unenforceable for two reasons: (i) the lease clause was actually drafted so poorly that it read that the tenant could never open the door, let alone leave it open, without being assessed a penalty; and (ii) the imposition of a charge every time the door was opened, or left open, was grossly disproportionate to any actual injury which the Owner might suffer. Justice Smith granted the tenant's application to dismiss the Owner's non-payment proceeding and set a hearing date for a determination of an award of legal fees to the tenant.

While this case involves a lease for store space within a privately owned building, as opposed to a cooperative or condominium, the legal principles apply to all contracts, including leases and proprietary leases. Contractual provisions in leases, including proprietary leases, which attempt to fix damages, will only be upheld by New York courts if the charge imposed bears a reasonable proportion to the probable loss and the actual amount of loss is difficult or incapable of precise estimation. Since it is but an estimate, a penalty clause need not be perfectly proportioned. It may not, however, be grossly disproportionate to the probable or actual loss sustained by the Owner. In those circumstances where damages cannot be reasonably determined, the courts have looked for reasonable efforts by the parties to establish appropriate compensation under the circumstances.

To survive a challenge, a lease provision that imposes a charge must be supported by a reasonable relationship to the anticipated damage, and a property owner or cooperative corporation or condominium association should be prepared to demonstrate its basis for the adopted fee. Without the ability to demonstrate a reasonable basis for the fee structure and its relationship to the actual loss or damage that may have occurred, courts are likely to consider the fee an unenforceable penalty. With this principle in mind, we urge you to review your late payment fees, renovation charges, and other similar fees.