

CLIENT ADVISORY

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THE BOARD'S POWER UNDER THE BUSINESS JUDGMENT RULE

In Levandusky v. One Fifth Avenue, 75 N.Y.2d 530, 554 N.Y.S.2d 807 (1990), the New York Court of Appeals applied the so-called "business judgment rule" to residential cooperatives. This rule provides that a court should defer to a cooperative board's determination so long as it acts for the purposes of the cooperative, within the scope of its authority and in good faith. As the Court said in Levandusky, the rule rests on the principle that "the purchase of a cooperative apartment represents a voluntary choice to cede certain of the privileges of single ownership to a governing body, often made up of fellow tenants who volunteer their time, without compensation. The board, in return, takes on the burden of managing the property for the benefit of the proprietary lessees."

More recently, in its May 2003 decision in 40 West 67th Street v. Pullman, 100 N.Y.2d 147, 760 N.Y.S.2d 745 (2003), the Court of Appeals permitted a cooperative, by a two thirds vote of its shareholders, to terminate the tenancy of one of their number for conduct they deemed to be objectionable. Although it rested its decision on the Levandusky case and on the business judgment rule, and much of its discussion was framed in terms of the rights and responsibilities of corporate boards, the Pullman decision did not involve board action but rather a vote of the shareholders. It was therefore not clear authority for the power of a cooperative board to take such drastic action as termination of a proprietary lease. Indeed, there has been disagreement among legal commentators since Pullman as to whether boards (as opposed to the shareholders) should have such power as a matter of policy. Judicial decisions have come down over the last year, however, that have started to clarify the views of the courts on this question, as well as on the extent of a cooperative board's powers generally.

Horwitz v. 1025 Fifth Avenue, Inc., 7 A.D.3d 461, 777 N.Y.S.2d 482 (1st Dep't 2004), did not involve the termination of a tenancy, but some observers have interpreted it as an especially far-reaching application of the business judgment rule. On closer examination, however, the case appears to represent only an examination by the Court of the three prerequisites for the application of the rule as set out in Levandusky and Pullman that the action be (1) for the purposes of the corporation; (2) within the scope of the board's authority; and (3) taken in good faith. In Horwitz, the board had adopted a policy restricting the use of air conditioners to through-the-wall installations. One tenant's effort to comply, however, was prevented by a 30 foot awning that was anchored to the exterior facade under his bedroom windows and shaded the terrace of the apartment below. Although the house rules had, since 1994, required the board's written consent for any awnings, windows or window guards and the downstairs tenants' awning had never been so approved, it was undisputed that the awning had been there since 1954 without any objection or complaint. When the board demanded removal of the awning, the downstairs tenants sued for a declaratory judgment.

The lower court denied summary judgment to the board, granted the plaintiffs summary judgment to the extent of declaring that they were not in violation of their proprietary lease and had a “license” to maintain the awning, and enjoined the cooperative from acting against it. The Appellate Division unanimously reversed, however, and declared that the corporation was entitled to enforce its house rules with respect to the removal of awnings. The Court found that “irrespective of whether it was permissible at the time it was installed,” the house rules now prohibited the awning and the cooperative’s right to require its removal was preserved by the “nonwaiver” provision in the proprietary lease. Moreover, it found that the rule prohibiting awnings was not discriminatory and there was therefore a presumption that the directors exercised their honest judgment to promote lawful and legitimate corporate interests. Since the case did not involve the termination of any tenancy, which the Pullman court had said would require “heightened vigilance” in examining a board’s decision, the Court deferred to the board’s exercise of its business judgment.

In a series of even more recent cases, the Landlord-Tenant Court has been confronted with attempts by cooperative boards to terminate a shareholder’s tenancy and have clarified at least that court’s view of the board’s power in such a situation. In 13315 Owners Corp. v. Kennedy, 4 Misc.3d 931, 782 N.Y.S.2d 554 (Civ. Ct. N.Y. Co. 2004), the board voted to terminate a shareholder’s tenancy because of allegedly objectionable behavior of his subtenant (who had performed unauthorized renovations, caused fires and been arrested twice on drug charges, among other things), as well as the shareholder’s alleged failure to cooperate in removing the subtenant. The Court denied the cooperative summary judgment in its proceeding to end the shareholder’s tenancy and directed a trial on whether the conduct complained of was objectionable and how much of it could be attributed to the shareholder. It held that the board had failed to follow proper procedures under its governing documents (the notice of the meeting bore the incorrect corporate name; no corporate officer signed the notice; the directors had not been properly elected) and had acted in bad faith by denying the shareholder and his lawyer the right to speak at the meeting. The Court held that termination of the tenancy was not within the Board’s authority and the business judgment rule was not applicable. Although it discussed at length the question of whether Pullman applies to a vote of directors rather than shareholders, it did not decide that issue.

More recently, in London Terrace Towers, Inc. v. Davis, No. 099330/03, 2004 WL 2827658 (Civ. Ct. N.Y. Co. December 6, 2004), the Landlord-Tenant Court upheld a Board’s decision to terminate a shareholder’s lease. It found that even under the “heightened vigilance” required in a termination case, the properly elected board had scrupulously acted within its authority and pursuant to the proprietary lease and had provided the shareholder-tenant with proper notice and a forum to respond. It even gave him a second chance to reform the objectionable conduct (which included excessive noise and cluttering of the hallways, fires and alleged sexual activity in the health club) and made a transcript of the meeting at which he defended himself. The Court held that the business judgment rule as described in Pullman should and did apply to cooperative board actions to terminate a tenancy.