

# CLIENT ADVISORY

JANUARY 2002

## PANEL DISCUSSION ON SECURITY ISSUES

Ganfer & Shore, LLP will be hosting a seminar on security issues in our series of breakfast panel discussions addressing topics that, we believe, are of significant interest to cooperatives, condominiums and real estate owners. This discussion will be held on Wednesday, January 23, 2002 from 8:00 A.M. to 9:30 A.M. in the Broadway Room located on the Conference Floor of the New York Grand Hyatt Hotel, at the corner of 42<sup>nd</sup> Street and Lexington Avenue. The panelists will be **Steven J. Shore, Esq.** of Ganfer & Shore, LLP; **Stephen J. Broward**, Managing Director of New York Security Service Group; **Mickey Schwartz, Sr. V.P. & C.O.O** of Triumph Security Corp.; and **Michael Wolfe**, President of Midboro Management Inc. If you plan to attend, please either call Amarilys Garcia of our office at 212-922-9250, ext. 262, or send a confirming e-mail to her at [agarcia@ganshore.com](mailto:agarcia@ganshore.com) by January 18, 2002.

## WHO'S LIEN IS IT ANYWAY?

In a battle over unpaid maintenance due from a defaulting shareholder, the Plaintiff, a cooperative corporation (the "Corporation") brought suit against the Dime Savings Bank of New York (the "Dime"). Dime had originally financed the defaulting shareholder's purchase of the stock and proprietary lease. When its borrower, the defaulting shareholder, failed to make her loan payments, the Dime foreclosed on its security interest in the shares of stock, and purchased the stock at the foreclosure sale. The defaulting shareholder, however, had failed to make maintenance payments for nearly three years prior to the foreclosure sale. The Corporation sought payment of the outstanding maintenance from Dime, and Dime refused, resulting in the suit by the Corporation.

The Corporation relied upon a legend which had been placed upon the stock certificates that stated that the Corporation "shall have a first lien upon the shares of such shareholder to secure the payment by such shareholder of all rent to become payable by such shareholder." Notwithstanding the legend, the Supreme Court denied the Corporation's right to recover maintenance for the period prior to the foreclosure sale. The Corporation appealed the decision to the Appellate Division. In Berkowners, Inc. v. The Dime Savings Bank of New York (NYLJ 9/26/01, page 21, col. 1), the Appellate Division reversed the lower court's decision. The Appellate Court relied upon prior decisions characterizing shares of a cooperative corporation as "securities" governed by Article 8 of the Uniform Commercial Code (the "UCC"). At the time of the decision, Section 8-209 of the UCC stated "a lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer is conspicuously on the security certificate." Since the Corporation's stock was marked with the legend noting that the Corporation "shall" have a "first lien" upon the shares of stock for any unpaid maintenance charges, the Appellate Court permitted the Corporation to enforce its lien for all unpaid maintenance against Dime, including the maintenance due for the years prior to the foreclosure sale.

Effective July 1, 2001, Section 8-209 of the UCC was amended to state that “a lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer is conspicuously on the security certificate *or, in the case of a cooperative, is set forth in the cooperative record*”. While the amendment offers cooperatives flexibility, stock certificates should be conspicuously marked to ensure a cooperative’s priority over all future third party purchasers.

This case was a dispute between a lender and a cooperative corporation where there appears to have been no recognition agreement. A recognition agreement should be required and signed by a new lender before the issuance or assignment of shares to the new purchaser, and will clearly establish the priority of the cooperative’s lien for unpaid maintenance as against the lender.

### **NOT VERY NEIGHBORLY**

In the case of Farnsworth v. Wells (NYLJ 11/28/01 p. 27, col. 4), the owner of a cooperative unit (“Plaintiff”) brought an action against her neighbor for a judgment declaring that her living room was smaller than it was supposed to have been when she purchased her unit 13 years earlier, and sought an order permitting her to remove and relocate her living room wall to another location inside of her neighbor’s apartment. Plaintiff, quoting her Lease, asserted that the Lease conveyed to her “exclusive possession of the real property contained within the four (or more) walls of the apartment”. She alleged therefore that she owned the wall and wanted it moved back to what she alleged was its original location. Plaintiff attempted to rely upon representations of the dimensions of apartments that appeared in the Plan. The Plan indicated that a typical unit in the Plaintiff’s line of apartments was 14’ 5” x 20’10” but did not describe Plaintiff’s particular apartment (or her neighbor’s). In contrast, the court reiterated the longstanding rule that the corporate corporation “is the sole owner of the land, structures and facilities, while the individual shareholder through the proprietary lease receives the right to occupy the space in the premises to which his or her shares are allocated”. The descriptions of various apartments with appropriate room dimensions in the prospectus was followed by a statement that the “layouts of apartments have been modified from apartment to apartment”. The Plan also stated that all apartments were offered “in their current condition”. Based upon the qualifications in the Plan, coupled with the fact that the Plaintiff could not demonstrate that anyone, including her neighbor, had moved her living room wall, the court summarily dismissed her case.

In a similar case, our office used the terms of an offering plan to defeat a shareholder’s claim that she was entitled to the use of a portion of the cooperative’s roof. In 1050 Fifth Avenue, Inc. v. May (247 A.D. 243, 1998), a shareholder had openly used a portion of the cooperative’s roof as a terrace for 30 years through a door from her unit to the terrace. The Appellate Court relied upon the offering plan and proprietary lease to determine that the area outside of the shareholder’s unit was not part of her apartment even after 30 years, and that her use was a license revocable by the cooperative. Both of these case make clear that when there are disputes concerning spatial rights, or the fiduciary duty of board members with respect thereto, the starting point should always be the offering plan and proprietary lease.