

CLIENT ADVISORY

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COOP REQUIRED TO CHARGE SALES TAX ON ELECTRICITY

Since its founding in 1960, Mutual Redevelopment Houses, Inc., (“Mutual”) a cooperative housing corporation which owns 2,820 moderate income apartments in buildings located between 23rd Street and 29th Street and Eighth and Ninth Avenues in Manhattan, has been providing electricity to its tenant/shareholders, the cost of which originally was included in the maintenance charges. In 1982, in an effort to reduce electric consumption, and encourage conservation, Mutual began submetering apartments, and billing shareholders based upon their actual consumption of power. In 1986 Mutual began to produce most of the power consumed by its shareholders by operation of a “co-generation” energy plant. The New York State Department of Taxation & Finance performed an audit covering the period September 1, 1990 through November 30, 1993, and assessed Mutual sales tax of \$186,479 plus interest, for that period.

Mutual objected to the imposition of the sales tax, arguing that the payments are not separate and independent transactions, and that under a 1993 Court of Appeals decision entitled Debevoise & Plimpton v. New York State Department of Taxation & Finance, sales tax is only assessable with respect to heating, ventilation and air-conditioning services if they are furnished in an identifiable sale transaction as a commodity or article of commerce, and not when included as part of a lease agreement.

Administrative Judge Winifred M. Maloney, upheld the determination of the Division of Taxation, holding that “...since each residential and commercial tenant’s monthly electricity charge is based on his actual consumption of electricity measured by submetering, that charge is indicative of the amount of electricity consumed by each tenant...” and so Judge Maloney determined that such submetering and usage based billing constituted independent sales of electricity.

This ruling, which is subject to appeal, appears to be based upon the fact that Mutual actually produced its own electricity, and that no sales taxes were being paid on such sales. In the case of a Cooperative which purchases power from a commercial supplier, such as ConEd, the sales taxes are paid on the bulk purchase.

NO RIGHT TO WITHHOLD COMMON CHARGES

Barbara Rubens (“Rubens”) did not pay the common charges assessed by The Hayden on the Hudson Condominium (the “Condominium”), in which she was a unit owner, for an acknowledged period of fifteen (15) months. In addition, the Condominium claimed that Rubens had not paid some \$2,165.78 which had been carried forward from the previous management’s books in January, 1997. The Condominium brought an action seeking judgment against Rubens for the unpaid common charges plus interest. Rubens asserted as an affirmative defense that she had stopped paying common charges because of damages sustained by her as a result of the Condominium’s breach of contract to make repairs consistent with the Condominium bylaws. Rubens also counterclaimed for punitive damages totaling \$50,000,

alleging that the Board had breached of its fiduciary duty to her and had violated the Condominium bylaws. The Condominium contended that the Business Judgment Rule barred both the affirmative defense and the counterclaims.

The Court held that absent a showing of fraud, self-dealing or unconscionability, the Court's inquiry is limited and it would not inquire as to the wisdom or soundness of the business decision. Since Rubens was unable to demonstrate that the Board's actions had been either fraudulent or unconscionable (the Condominium having offered evidence to show that the board was dealing with repair issues), the Court held that Rubens did not have the right to withhold her common charges.

The Condominium, however, was not awarded any portion of the \$2,165.78 carry-forward balance it sought, since the Court held that the Condominium's failure to bring an action sooner put Rubens at an unfair disadvantage, since she had, in the interim, discarded the cancelled checks which would have proven her payments.

As a matter of principal, since numerous decisions have held that the failure to pursue maintenance and/or common charges may result in such claims being dismissed, we urge all Cooperatives and Condominiums to promptly pursue any shareholder or unit owner arrears, so that those claims do not become stale, and those arrears unrecoverable.

LETTER TO SHAREHOLDERS MAY BE DEFAMATORY

Shortly after his election to the board of 413 East 82nd Street Apartment Corporation, Theodore I. Sandler, and the board of directors of the Cooperative, decided to investigate the former president, Mark Holt. Sandler ordered an investigative consumer report from American Tenant Screen Incorporated, apparently falsely stating that Holt had consented to the investigation. In addition, the board circulated a letter containing a series of allegations apparently referring to Holt, and alleging that the Attorney General, the District Attorney and the S.E.C. were interested in investigating the purchase of a certain bond by the Cooperative, during Holt's tenure as president of the Cooperative, and that Merrill Lynch had been notified of serious suitability issues surrounding the bond purchase.

Holt brought suit against the Cooperative and Sandler, alleging breach of the Federal Fair Credit Reporting Act, defamation, and slander, and seeking attorneys' fees and punitive damages. The Cooperative and Sandler moved to dismiss the complaint, in lieu of serving their answer. The defendants alleged several technical flaws in Holt's complaint, including a failure to allege that the defendants conduct was misleading; and that the credit report was done in good faith in contemplation of a lawsuit against Holt for losses suffered by the Cooperative. The defendants also asserted that since the letter did not specify Holt by name, it was not defamatory, and that Holt's failure to attach a copy of the allegedly defamatory letter to the complaint was a fatal defect.

The Supreme Court (trial level), New York County (Justice Louis B. York), denied the defendants' motion, holding that Holt's claims were adequately pled, and that he might ultimately be successful on the merits of the action. The fact that the letter did not name Holt was held not to defeat the defamation claim, since Holt's identity was easily ascertainable, and most if not all of the shareholders receiving the letter would have known to whom it referred. As a consequence, the claims were not dismissed, and the action was ordered to continue.