

CLIENT ADVISORY

JULY 2002

TO SELL OR NOT TO SELL ...REPRISED

Back in the September 2001 issue of our Newsletter, our attention was focused on the question: "Must a Sponsor sell its unsold apartments in a cooperative or condominium?" In 511 West 232nd Street Owners Corp. v. Jennifer Realty Co. (A.D., 1st Dept., 8/9/2001), a unanimous panel for the Appellate Division, First Department, had held that implied in the conversion of a building to a cooperative is a promise by its sponsor to sell all of its unsold units within a reasonable time. On June 11, 2002, New York's highest court, the Court of Appeals, affirmed only that portion of the order of the Appellate Division which denied the Sponsor's motion to dismiss the Cooperative Corporation's ("Corporation") complaint. The highest court's decision was carefully tailored to merely address the sufficiency of the Corporation's complaint to defeat the Sponsor's motion to dismiss, emphasizing that implied in all contracts in New York is a covenant of good faith and fair dealing, and that the Sponsor's documentary evidence, including the Offering Plan, did not clearly refute the Corporation's allegation that they reasonably understood the Offering Plan to state a duty, at the very least, to sell a sufficient number of shares in a timely manner so as to create a viable cooperative. Since the Appellate Division's decision had been determined before the Sponsor had actually answered the Corporation's complaint, the Court of Appeals refused to now address the merits of the Corporation's claims, leaving a final answer to our question until after further proceedings between the parties.

Notwithstanding the stated limitations of the Court of Appeals' decision, the survival of the Corporation's claims establishes a basis upon which other groups of disenchanted shareholders may attempt to proceed against Sponsors holding large numbers of unsold shares and who are allegedly making less than a reasonable effort to sell the unsold units. The success or failure of such claims will depend upon the facts attendant to each building, including, without limitation, the acts or omissions of the Sponsor throughout the conversion process and to the present day, as well as the terms of the Offering Plan. We previously anticipated that the Appellate Division's decision, if upheld, might open the floodgates to a myriad of claims by cooperative and condominium apartment owners in buildings throughout New York in which sponsor-owned apartments still make up a significant percentage of the apartments in the building. However, at this time, the Court of Appeals only let through a trickle, with the potential for a flood of suits waiting in the wings. We will continue to follow this matter and attempt to keep you informed of future developments as they are reported.

MORE NEWS ON POST 9/11 TERRORISM INSURANCE COVERAGE EXCLUSIONS

In last month's Newsletter, we highlighted the case of Four Times Square Associates, L.L.C. v. Cigna Investments, Inc. (NYLJ, May 7, 2002, p. 18, col. 1) to illustrate the potential problem facing all mortgage borrowers in New York. Briefly, in April, 2002, LaSalle National Bank (the "Bank"), the holder of a \$430,000,000 mortgage on the Conde Nast building located at Four Times Square, had notified Four Times Square Associates, L.L.C. (the "Owner"), that it was in default on its mortgage because its "all risk" insurance policy no longer covered acts of terrorism. The Owner immediately went to court for an injunction, seeking to prevent the Bank from seizing between \$3,500,000 and \$5,000,000 from building

rents in order to pay one year's premium on a terrorism policy. Justice Harold Tompkins had granted the Owner a temporary injunction but, at a hearing several days later, partially vacated his injunction permitting the Bank to seize the money to pay the premium. Justice Tompkins had concluded that the potential harm from a lack of insurance outweighed the Owner's potential damage caused by purchasing the coverage. At the time of publication of our June 2002 Newsletter, the Appellate Division had stayed Justice Tompkins' ruling pending a decision by Justice Tompkins on the merits of the Owner's application for a preliminary injunction.

On June 21, 2002, Justice Tompkins denied the Owner's application for a preliminary injunction, dissolving the interim stay granted by the Appellate Division, and permitted the Bank to take millions of dollars from the building's rents to purchase terrorism insurance coverage. In his decision, Justice Tompkins examined 2 different insurance clauses in the Bank's loan documents. The first clause required the Owner to obtain "all risk" coverage. The court noted that terrorism insurance had, prior to September 11, 2001, been a part of "all risk" coverage. The second insurance clause permitted the Bank's trustee to reasonably request insurance for losses not covered by the "all risk" policy so long as the coverage was generally available at commercially reasonable premiums. Addressing this significant question, Justice Tompkins stated that whether terrorism insurance is, in the post-September 11, 2001 world, part of the new custom of business, and is generally available at commercially reasonable premiums, is a matter of fact for a jury to decide.

Consistent with his earlier decision, Justice Tompkins emphasized that the insurance premium, though substantial, was still only money and insufficient to demonstrate the irreparable harm necessary to support a grant of injunctive relief. Justice Tompkins also noted that the Owner still had its claims against the Bank if the court were to determine, on the merits, that the request for terrorism insurance was not permitted by the terms of its loan documents, and could possibly, in the interim, seek to recover the additional costs from its tenants, depending upon the provisions of each lease.

We understand that the Owner intends to appeal Justice Tompkins' decision. We will continue to follow this matter and attempt to keep you informed of developments in this case.

15 NEW YORK CITY PLUMBING INSPECTORS CHARGED

In a repeat of charges brought against several of the same plumbing inspectors in 1993, on June 26, 2002, the United States Attorney for the Eastern District announced that 4 former inspectors and 15 of New York's 24 current plumbing inspectors, including the top inspector and the top supervisors in Manhattan, Brooklyn, Queens and the Bronx, were charged with extorting hundreds of thousands of dollars to approve projects throughout the City of New York. The inspectors arrested were Neil Muccio, John Rosenberg, Sam Caravello, George Friedlander, Emanuel Lauria, Thomas DeGoski, Vernon Giles Jr., Robert Chait, Anthony Diberandino, Franko Dobric, Steven Ferrara, John Hansen, Martin Lara, Carlos Perez, Daniel Sacknoff, Gregory Sahakian, Frank Sgambati, Carl Termine and Joseph Truc. As reported in the New York Times, the arrest leaves only 9 plumbing inspectors throughout the City to perform the more than 150 inspections required each day. We suggest that cooperative and condominium boards have their managing agents check to see if any of the named inspectors approved any work in their building. If they did, boards may wish to consider having the work inspected again to see if the work was actually performed by the building's contractors in compliance with code and in a legal and safe manner.