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# CLIENT ADVISORY

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## **GOVERNING DOCUMENTS, NOT ATTORNEY GENERAL'S RULES, DETERMINE WHO IS A HOLDER OF UNSOLD SHARES**

When a building converts from a rental property to cooperative ownership, typically not all the units in the building will be purchased by individuals intending to occupy them. The sponsor may then sell the remaining units to third parties who intend to hold each unit for investment purposes, rather than for use as their residence. These investors are designated as "holders of unsold shares." A holder of unsold shares receives a proprietary lease to the apartment, but has rights beyond those of an ordinary shareholder/proprietary lessee. These rights are specified in the proprietary lease and typically include the right to sublet the apartment without board approval and without regard to the board's restrictions on frequency or duration of subletting, as well as the right ultimately to sell the apartment without board approval.

Recent years have seen a series of litigations in which boards have sought, with mixed success, determinations that proprietary lessees claiming to be "holders of unsold shares" do not enjoy such status and are, therefore, subject to the same rules governing subletting and apartment sales as other owners. Frequently, boards have contended that a putative "holder of unsold shares" lost that status for failure to comply with the Attorney General's regulations (13 NYCRR Part 18) governing cooperative offering plans.

In Kralik v. 239 East 79th Street Owners Corp., 2005 N.Y. Slip Op. 05116, 2005 WL 1403491 (June 16, 2005), the Court of Appeals, New York's highest court, unanimously held that a cooperative board may not rely upon the Attorney General's regulations to dispute a proprietary lessee's status as a "holder of unsold shares." This litigation arose from a prolonged dispute between the cooperative board and a lessee concerning subletting rights. The trial court and the Appellate Division held that the lessee had never become a holder of unsold shares because the sponsor and the lessee had not complied with several provisions of the Attorney General's regulations. The Court of Appeals reversed, holding that the Attorney General's regulations apply only in connection with public offerings of shares, and therefore do not govern a dispute concerning subletting rights. The Court also held that even when the regulations became applicable, such as would occur if the lessee offered the shares for sale to the public, only the Attorney General may enforce his regulations and a private party lacks standing to do so.

The Court concluded that only "the terms of the controlling documents – not Part 18 – determine whether plaintiffs are holders of unsold shares." Thus, future board challenges concerning status as a holder of unsold shares will be governed solely by these documents, such as the cooperative's offering plan, certificate of incorporation, bylaws, and proprietary lease.

## **CONDOMINIUM MAY LIMIT PURCHASES OF CERTAIN UNITS TO EXISTING RESIDENTS**

Unit holders of a condominium may adopt bylaws limiting the transfer of certain units in the building to the building's existing residents, the Appellate Division recently held in Demchick v.

**90 East End Condominium, 2005 N.Y. Slip Op. 04322, 2005 WL 1270763 (1st Dep't May 31, 2005).**

The decision describes 90 East End Avenue as a luxury building containing 38 large residential units as well as 5 smaller second-floor apartments deemed suitable for residents' household help. Plaintiffs owned a large unit as well as one of the studios, which they used for storage, but were considering selling the studio to a non-resident. The condominium bylaws originally contained no restrictions on transfers of the studio apartments, but the building's owners subsequently voted to amend the bylaws to allow resale of the studios only to existing residents of the building.

Plaintiffs then sued to void the bylaw amendment as an unreasonable restriction on alienation of their property. The trial court agreed that the amendment was unreasonable because the restriction on resale was of unlimited duration. The appellate court disagreed, however, and upheld the restriction. The court held that the restriction was valid because it served the reasonable purpose of "preserv[ing] the character of the Condominium." Moreover, the court held that the restriction did not violate the principle that restrictions on alienation cannot be of unlimited duration, because the restriction could be modified or removed at any time by vote of the unit owners.

**BYLAW DISCLAIMING RESPONSIBILITY FOR MAINTAINING PIPES AND WINDOWS HELPS CONDOMINIUM AVOID LIABILITY**

A recent negligence case provides a reminder that cooperative boards and condominium associations should ensure that their governing documents make clear which maintenance responsibilities are the responsibility of individual unit holders, rather than of the cooperative or condominium.

In Gorgoni v. Sideris Plumbing & Heating Corp., 794 N.Y.S.2d 344 (1st Dep't May 3, 2005), a condominium resident sued for water damage caused by a leak from a pipe in the apartment of his upstairs neighbor, which allegedly had frozen because the upstairs apartment window was left open in cold weather. The complaint sought damages from the neighbor, the Condominium, and the management company. The lower court granted summary judgment dismissing the complaint against all defendants. On appeal, the Appellate Division reinstated the complaint against the neighbor, who, the court found, might have been negligent in leaving his window open before taking a lengthy out-of-town trip during the winter. However, the court affirmed dismissal of the Complaint against the Condominium and its management company, noting that "neither of these defendants had any responsibility, under the condominium bylaws, for the maintenance of the exposed sprinkler pipe or the window" within a unit.

As demonstrated by this case, governing documents containing language specifying which maintenance and repairs are the responsibility of the individual owners or tenants, will minimize the possibility of liability for, or a prolonged litigation concerning, maintenance or repair issues that should not be the cooperative's or condominium's responsibility.