
CLIENT ADVISORY

JUNE 2003

THE RIGHT OF A COOPERATIVE TO TERMINATE A SHAREHOLDER'S TENANCY

Relying on the "business judgment rule," the New York Court of Appeals on May 13, 2003 held that a residential cooperative could terminate the tenancy of a shareholder based on conduct that the cooperative deemed objectionable.

In 40 West 67th Street Corp. v. Pullman, NYLJ May 14, 2003, p.20, col. 1, the tenant-shareholder had engaged in a course of conduct that, "in the view of the cooperative, began as demanding, grew increasingly disruptive and ultimately became intolerable," including vituperative letters to and complaints about his neighbors that were determined upon the Board's investigation to be baseless. In addition, he made alterations to his apartment without Board approval, had construction work performed on weekends in violation of house rules and would not respond to requests by the Board to correct these conditions. When he began commencing lawsuits against the neighbors, the cooperative management and its president, the corporation convened a special meeting and, pursuant to a provision of the proprietary lease authorizing it to do so, voted by more than a two thirds majority (in fact, 100% of those present) to terminate his proprietary lease and cancel his shares because of the Lessee's "objectionable conduct." When the tenant ignored a notice to terminate, the cooperative commenced a proceeding to eject him and cancel his stock, as well as for a money judgment for his use and occupancy and its attorneys' fees. The tenant-shareholder defeated the cooperative's proceeding in the lower court, primarily on the basis of **Real Property Actions and Proceedings Law ("RPAPL")**, §711(1), which provides that an eviction proceeding on such grounds is not maintainable "unless the landlord shall by competent evidence establish to the satisfaction of the court that the tenant is objectionable." The Appellate Division reversed, however, and the Court of Appeals agreed, holding that the "competent evidence" requirement of RPAPL §711(1) is satisfied by the deference courts are required to give to the vote of the shareholders or the board of directors under the "business judgment rule."

The business judgment rule, which was first developed in the context of challenges to decisions made by directors of commercial corporations, "bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes." Auerbach v. Bennett, 47 N.Y. 2d 619, 629, 419 N.Y.S.2d 920, 926 (1979). The principle was applied to residential cooperatives in Levandusky v. One Fifth Avenue Apt. Corp., 75 N.Y.2d 530, 554 N.Y.S.2d 807 (1990), a dispute over a tenant-shareholder's relocation of a hot water riser without board permission, in which the Court of Appeals held that the courts will not substitute their judgment for the board's, "so long as the board acts for the purposes of the cooperative, within the scope of its authority and in good faith..." In the Levandusky Court's view, board members have experience of the peculiar needs of the building and to permit an owner dissatisfied with

a board action to reopen the matter completely before a court that is unfamiliar with the property and to challenge the reasonableness of the action “threatens the stability of the common living arrangement.”

In the **Pullman** decision, the judicial deference to cooperative board decisions is now extended to shareholder votes to evict, once a court is satisfied that the shareholder action was authorized by the proprietary lease, has a legitimate relation to the cooperative’s purposes and was not the product of bad faith, arbitrariness, favoritism, discrimination or malice on the cooperative’s part. Although it cautioned against “a rubber stamp of cooperative board actions, particularly those involving tenancy terminations,” the Court limited the scope of judicial review and has given boards (and the majority of residents) considerable freedom in dealing with recalcitrant tenant-shareholders.

PENALTIES IN ALTERATION AGREEMENTS

In **179 East 70th Street Corp. v. Steindl**, NYLJ May 14, 2003, p. 21, col. 3 (Civil Ct. N.Y. Co.), the Court refused to enforce a \$500 per day charge imposed by a cooperative corporation for work on a tenant’s apartment that extended beyond the agreed completion date. Moreover, the Court’s language suggests inherent problems in the enforcement of clauses of this type.

“Liquidated damages” are a sum that the parties to a contract agree should be paid to satisfy any loss flowing from a breach of the contract. Traditionally, they are only enforceable if the agreed amount “bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation.” **Pyramid Centres and Company, Ltd. v. Kinney Shoe Corporation**, 244 A.D.2d 625, 627, 663 N.Y.S.2d 711 (3d Dep’t 1997). Such provisions are commonly used in alteration agreements in cooperative buildings and, for work that exceeds the agreed time, are frequently a multiple of the estimated cost. If the amount to be paid is grossly disproportionate to the amount of actual damages, however, it is no longer liquidated damages but rather a coercive “penalty” and is unenforceable. **Id.**

The Court in the **Steindl** case found the \$500 daily charge to be grossly disproportionate to the actual expense caused by the delay of completion and therefore an unenforceable penalty. However, it permitted the corporation to recover its actual proven damages, stating that “any damages suffered by [the corporation] are calculable.” This statement does not appear to take into account such hard-to-measure damage to the building’s occupants as noise, dirt, dust and interference with elevator use, but suggests that even apart from the disproportionate amount of the stipulated sum, the other necessary element of a valid liquidated damages claim—the impossibility or difficulty in calculating damage—was lacking. If so, the liquidated damages provision may be ineffective even if the number were more reasonable. Cooperatives should therefore be cautious in relying on so-called “liquidated damages” clauses and should consult with counsel in drafting them. Certainly, charges in alteration agreements disproportionate to the expected actual costs should be avoided.

Indeed, disproportionately large flat charges should be avoided in other contexts as well, such as with late payments, where charges equivalent to actual processing costs or a modest percentage of the late payment should be considered instead of the substantial flat fees imposed by some cooperatives.