

CLIENT ADVISORY

MARCH 2003

AN ATTEMPTED SLEIGHT OF HAND EXPOSED

In mixed-use condominiums, which may include residential and commercial or professional units, the apportionment of common expenses amongst the different types of users is a significant financial issue and often leads to disagreements. In the case of Lesal Associates v. Board of Managers, Downing Court Condominium, (NYLJ, 2/11/03, p. 21, col. 2), Lesal Associates, the former owner of the 32 residential units and the current owner of the one (1) commercial and one (1) professional unit (the "Plaintiff") contended that the residential owners sought improperly to re-allocate common charges so that Plaintiff's share would substantially increase. For the approximately three-year period during which the parties discussed a resolution of this issue, without success, the disputed re-apportionment withheld by Plaintiff grew to \$361,264.33.

The dispute arose out of a change in the Condominium Board's method of allocating common charges to the various types of units. Prior to the dispute, the Condominium had allocated common charges based upon either a unit owner's exclusive use of common areas or the availability of common areas to particular unit owners. Under this method, the common charges assessed would reflect the unit owner's actual use of the common areas. The new method adopted in 1999 by the Condominium's Board of Managers was based upon the percentage of total space in the building that the unit owner occupied. Plaintiff took the position that this newly adopted method would cause Plaintiff's percentage to increase substantially and result in the Plaintiff effectively paying for the resident unit owner's use of the residential portions of the Condominium. In response, the Condominium commenced an action seeking payment of the substantial sum claimed to be unpaid by the Plaintiff.

The court's review focused upon the formation documents of the Condominium, including the Offering Plan, Declaration, and By-Laws to determine the intention of the documents and to give meaning to the provisions within these documents. The court found significant the fact that the common charges had been allocated in the manner sought by the Plaintiff for twelve (12) years prior to the change by the Board of Managers. Upon review of the Condominium's documents, the court found it clear that the documents envisioned that unit owners would pay for the common services that they used, rather than a straight apportionment of all of the common expenses based upon the square footage of a unit owner's unit in relation to the total square footage within the Condominium. The court granted the Plaintiff summary judgment declaring that the Condominium could not allocate residential common expenses to the owner of the commercial and professional units and that Plaintiff's charges were to be limited to common charges which reflected the commercial unit owner's and professional unit owner's use of the common elements of the Condominium.

When considering reallocations of operating costs and expenses which may have a differing financial impact upon unit owners, boards need to be aware that the courts will not only review a board's

past practices, but the provisions of all of its formation documents including, without limitation, an Offering Plan, Declaration, Proprietary Lease and By-Laws in order to ensure not only that the board's decision is consistent with the procedures established in those documents, but also their substantive provisions.

NEW STATE LAW REGULATES WITHHOLDING OF PAYMENTS TO CONTRACTORS

On July 18, 2002, Governor Pataki signed into law the Construction Contracts Act of 2002 (the "Act"), which became effective on January 14, 2003. Board members and property owners must be aware of this new law in that it sets forth specific time frames, procedures and guidelines for a work stoppage by a contractor, as well as a property owner's withholding of payment to the contractor. The Act generally applies to private, commercial projects valued in excess of \$250,000, and excludes, in pertinent part, residential construction projects where the aggregate size is 9,000 square feet or less, and individual one, two and three-family residential dwellings. The Act contains "Non-Mandatory Rules", defined as those rules which apply in the absence of an agreement between the parties, and "Mandatory Rules", which the parties may not contract away, and which set forth the remedies available to the contractor for the property owner's failure to either approve or disapprove an invoice in writing, or make payment on *undisputed* amounts in the contractor's invoice, within the time periods set forth in the contract. If no periods are established in the agreement, the Act requires that the property owner make specific objections in writing within 12 days of the property owner's receipt of the contractor's invoice. Unless otherwise agreed to in writing by the parties, the Act further provides that property owners must pay undisputed amounts in contractor's invoices within the later of either 30 days from the property owner's receipt of the contractor's invoice or the property owner's notice to the contractor disapproving a portion of the contractor's invoice. The remedies available to contractors under the Act include: (i) a 1% per month charge on all late payments; and (ii) the right of the contractor to stop work if a property owner fails to pay an *undisputed* amount after the property owner has been given ten days prior written notice and an opportunity to cure the non-payment by the contractor. All time frames for the contractor's performance in the agreement with the property owner are suspended until payment is received.

In light of the substantial projects being undertaken and to be undertaken by boards and property owners throughout New York, and the substantial financial impact which a work stoppage can have on a project, as well as the inconvenience which can be experienced by unit owners and their families during a dispute, it is imperative that board members and property owners know and understand their rights and remedies under this new Act. We recommend that no board or property owner enter into a substantial construction agreement covered by the Act without the assistance of counsel.

Shareholder Notification of D & O Insurance

As we have indicated in past newsletters, under §726 of the New York Business Corporation Law ("BCL"), corporations with directors' and officers' liability insurance are required to notify their shareholders annually of the following information: (i) name of insurance carrier; (ii) date of insurance contract; (iii) premium costs; and (iv) corporate positions insured. We suggest that your managing agent send out such notices each year.