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# CLIENT ADVISORY

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OCTOBER 2008

## CONDOMINIUM BOARD'S RIGHT TO SUE SPONSOR'S ARCHITECT FOR FAULTY DESIGN WORK UPHELD

An architect hired by the Sponsor of a Condominium has been required to defend against claims that its plans for a condominium building were faulty, in an action brought by the Condominium Board of Managers on behalf of itself and the individual unit owners. **Board of Managers of Marke Gardens Condominium v. 240/242 Franklin Avenue LLC, 20 Misc. 3d 1138(A), 2008 WL 4058677, 2008 N.Y. Slip Op. 51789(U) (Sup. Ct. Kings Co. Aug. 26, 2008).**

In this case, the Board of Managers alleged that the architect's plans for an elevator in the building had been defective, because the elevator design violated the Americans with Disabilities Act and local code requirements and could not be used. The architect moved to dismiss the claims for breach of contract and negligence, arguing that its contractual relationship was solely with the Sponsor, rather than the Board of Managers or individual unit owners, and therefore it owned no duty to the Board or unit owners. Rejecting this argument, the court observed that the architect had executed a certification in the Offering Plan. The certification was expressly "made for the benefit of all persons to whom this offer is made" and was for the purposes of affording "potential investors and participants an adequate basis upon which to found their judgment concerning the description of the property as it will exist upon completion of construction." Accordingly, the court found a sufficiently close relationship "approaching privity" between the architect and the Board to sustain the claims.

However, the court dismissed claims against the architect for alleged violations of New York General Business Law provisions barring deceptive trade practices and false advertising. The Board alleged that the architect had participated in disseminating deceptive promotional materials and purchase agreements to potential purchasers of condominium units. However, the architect responded without contradiction that it was never involved in disseminating any advertisements or brochures concerning the Condominium or in selling any units. Rather, its role was limited to certifying plans for filing with city agencies, which did not provide a basis for the statutory claims.

The court refused to dismiss the Board of Managers' claims against an individual who was the sole member of the Sponsor. The individual contended that any documents he signed in connection with the Condominium were signed on behalf of the Sponsor, so he could not be held personally liable. However, he had co-signed the sponsor certification, in which he asserted that he had the primary responsibility for compliance with the Martin Act and other applicable laws and regulations, that the offering plan contained no material misstatements or omissions, and that the offering plan afforded potential investors an adequate basis upon which to found their judgment. The court concluded that "[s]uch representations can be the basis for a separate cause of action against [this] defendant in his individual capacity." Lastly, the court dismissed claims against another company

that was under common ownership with the Sponsor and that had done contractor work on the project, because this company had not signed any documents making representations to purchasers.

**COURT DECISIONS PROVIDE GUIDANCE ON  
WHO IS A “HOLDER OF UNSOLD SHARES”**

An investor who acquires a cooperative unit as a “holder of unsold shares” enjoys rights not possessed by other tenant-shareholders, such as the ability to sublet or sell the unit without obtaining board approval and without paying fees such as subletting fees or “flip taxes.” Whether an owner is a holder of unsold shares is a frequently disputed issue. In 2005, the Court of Appeals held that a shareholder’s status as a “holder of unsold shares” must be determined based on the contractual documents between the Cooperative and the shareholder, such as the proprietary lease, and that the Attorney General’s regulations suggesting a definition of “holders of unsold shares” did not govern this issue. (For discussion of this decision, please see the July 2005 issue of this *Client Advisory*.)

Two recent appellate cases discuss when a shareholder will be deemed a “holder of unsold shares.” In **Kralik v. 239 East 79th Street Owners Corp.**, 54 A.D.3d 267, 862 N.Y.S.2d 507 (1st Dep’t 2008), the cooperative argued that the plaintiffs could not be “holders of unsold shares” because they had not complied with certain provisions of the offering plan which, the cooperative urged, were incorporated by reference in the definition of “unsold shares” contained in the proprietary lease. The court rejected this contention, holding that “nothing in the offering plan indicates that noncompliance with [these] provisions divests holders of unsold shares of that status.”

In **Sassi-Lehner v. Charlton Tenants Corp.**, 863 N.Y.S.2d 20, 2008 N.Y. Slip Op. 6584 (1st Dep’t 2008), the court held that plaintiffs were not “holders of unsold shares.” The shares had originally been owned by the Sponsor, which then sold them to an individual. The shares were then resold in a foreclosure sale, at which they were purchased by plaintiffs’ parents, who later transferred them to plaintiffs. When plaintiffs sought to sell the shares, a dispute arose as to whether they were “holders of unsold shares” entitled to transfer their shares without Board approval. Plaintiffs relied on a provision of the proprietary lease providing that unsold shares are shares that “were issued to the sponsor or individuals produced by the sponsor,” and that unsold shares retain that status “regardless of transfer” until they are acquired by a purchaser for the purpose of occupying the apartment. Plaintiffs’ argument implied that “unsold shares which were initially held by the sponsor may be transferred in perpetuity, regardless of who acquires them or how, whether by purchase or foreclosure.” The Board, disputing plaintiffs’ status as “holders of unsold shares,” relied on a provision of the offering plan, stating that a “holder of unsold shares” must be an individual who was designated by the sponsor to be such either at closing or within three years of the closing.

The court held that the contents of an offering plan may be considered together with the proprietary lease in determining who is a “holder of unsold shares.” This was necessary in this case, the court found, because the definition of “unsold shares” in the proprietary lease specifically cross-referenced language in the offering plan. Under the offering plan, “holders of unsold shares” would be either the Sponsor or persons produced by the Sponsor at the time of closing. Only the Sponsor was accorded the right to designate a “holder of unsold shares.” Although the phrase “regardless of transfer” in the proprietary lease was “problematic” for this interpretation, the court construed those words to include only transfers to other persons produced by the Sponsor. Accordingly, persons who acquired shares without having been designated to do by the Sponsor, such as purchasers at a foreclosure sale, could not be “holders of unsold shares.”