Transparency and Disclosure in Cooperative Housing:
Will 2017 be the Year the Bill is Finally Signed into Law?

By John Dolgetta, Esq.

The long-awaited Fairness in Cooperative Home Ownership Act (the "Co-op Act") may very well see its way to becoming law this year. The legislation passed the New York State Senate (Senate Bill S.5644) in June 2016, at which time it was also delivered to the New York State Assembly (Assembly Bill A.6395) (the "Bill"). The Bill was subsequently referred to the Assembly's Housing Committee for consideration, but failed to advance. It is currently still in the Housing Committee and it remains to be seen whether the Assembly will move the Bill to the floor for a vote in 2017 so that it may finally be sent to Governor Cuomo for signature and enactment.

The Co-op Act will amend the Real Property Law of the State of New York by adding a new Article 11 entitled "Cooperative Purchase Applications". As the legislature explains, "…residential cooperative purchasers are subject to processes and conditions that do not also apply to purchasers of other single family residences. The legislature also finds that these processes and conditions, at a minimum, give the appearance and have the potential to be misused to illegally discriminate against a purchaser of cooperative housing…." (See http://bit.ly/2ix7loQ). The Co-op Act seeks to protect prospective purchasers from potential abuses that do not exist with other types of real property, such as single-family dwellings and condominiums.

The New York State Association of REALTORS® ("NYSAR") strongly supports the enactment of the Co-op Act. In its memorandum in support ("2016 Memorandum") of the proposed law back in June 2016, NYSAR explains that "… the secretive nature of cooperative boards' application and review processes have an injurious effect on their clients, while also giving the co-op boards the ability to unfairly deny housing opportunities to persons deemed "undesirable". The result, potential buyers will meet all reasonable financial criteria for ownership, but they are illegally denied or rejected from purchasing shares in the cooperative." Ultimately, this is unfair and does not promote home ownership in a fair and consistent manner.

The Mechanics of the New Law

Hopefully, it should be just a matter of time before the Co-op Act is enacted, as there does not exist a substantive divide in the Assembly with regard to the merits of the law. The Co-op Act is meant to improve the transparency of the cooperative purchase process. It will streamline the application procedures and timelines and make the process uniform statewide. The Co-op Act sets forth a reasonable timeframe within which cooperative boards must act in rendering a decision as whether to approve or reject an applicant.

The cooperative board must acknowledge receipt of an application within ten (10) days of its receipt from the applicant. The cooperative board would then have forty-five (45) days from receipt of the application within which to render a decision. If the cooperative board rejects the application, it must provide a written statement as to its reasons for not approving the

prospective purchaser/applicant. If the cooperative board, or property management company acting on behalf of the cooperative board, fails to render a decision within said 45 days, then the application is deemed to be automatically approved. While the law seems fairly straightforward, the existence of the "Business Judgment Rule" makes the passage of the Law a bit more complicated.

This is Not a New Proposition but Still Old Opposition!

The Co-op Act is not unlike a local law already in effect in Suffolk County. Suffolk County passed a similar law waiting for the New York State Legislature to act. The Suffolk County Legislature passed "A Local Law Requiring Fairness in Cooperative Home Ownership" in 2009 *(Adopted 8-4-2009 by L.L. No. 28-2009 (Ch. 252, Art. I,of the 1985 Code)).* (See: http://bit.ly/2ixh52e). However, the Co-op Act has received its fair share of opposition. The lobby for cooperative corporation owners focuses its argument on the notion that board directors would be living in fear of lawsuits and that cooperative boards would be defending decisions previously made in the best interest of the cooperative corporation based upon the "Business Judgment Rule." The powerful opposition lobby is led by The Building & Realty Institute, the Westchester County-based Cooperative and Condominium Advisory Council, as well as the Council of New York Cooperatives and Condominiums. (See http://bit.ly/2ia6Yzx).

Cooperative boards have continuously used the Business Judgment Rule to justify decisions to deny or approve a purchaser/applicant but are not required to provide reasons for their decisions. Under the Business Judgment Rule, "absent a showing of discrimination, self-dealing or misconduct by board members, corporate directors [such as a Cooperative Board] are presumed to be acting in 'good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.'" *Graham v. 420 E. 72nd Tenants Corp. (2016 NY Slip Op 31002(U)).* Unfortunately, the Business Judgment Rule could be too easily used to hide discriminatory behavior. Passage of the Co-op Act will go a long way in protecting prospective homeowners from potential discrimination and self-dealing by cooperative corporations.

An Egregious Cooperative Case Study

One such recent case that demonstrates well how discrimination and self-dealing may be alive and well in cooperative boards is *Graham v. 420 E. 72nd Tenants Corp.* In *Graham*, the cooperative apartment shareholder sued the cooperative corporation for, among other things, (1) breach of fiduciary duty; (2) tortious interference with a prospective contract; and (3) breach of contract alleging that the Cooperative Corporation acted in bad faith and/or self-dealing in denying the purchaser/applicant.

The plaintiff, Sharie Graham ("Plaintiff"), was the owner of an apartment in and shareholder of the cooperative corporation known as 420 East 72nd Street Tenants Corp. (the "Defendant Corporation"). In the summer of 2014, when the Plaintiff expressed an interest in purchasing another unit in the Building, the Defendant Corporation expressed an interest in purchasing the Plaintiff's existing apartment because it wanted to use the Plaintiff's unit as a gym. Defendant Corporation was unresponsive and no further action was taken. In November 2014, Plaintiff's broker listed Plaintiff's existing apartment ("Unit") for a price of $499,000.00.

Shortly thereafter, the Defendant Corporation offered Plaintiff $400,000.00 to purchase the Unit and she declined the very low offer.

In December, Plaintiff accepted a cash offer in the amount of $495,000.00 from prospective purchasers and a contract of sale ("Contract") was entered into between them. The purchasers submitted their application to the Defendant Corporation and were denied in February. The Defendant Corporation's reasoning for the rejection was because the sales price was under market value. The rejection indicated that the Defendant Corporation would reconsider the application if the sales price was increased to $535,000.00. As a result, the Plaintiff and purchasers amended the Contract to reflect an increased purchase price of $535,000.00. Plaintiff also had an appraisal done of the Unit which came out at $525,000.00. The Defendant Corporation again denied the application and requested that the sales price be increased to $610,000.00 and this ultimately led to this action being filed. Unfortunately, it is not clear at all why the purchasers were denied.

The Defendant Corporation sought summary judgment relying on the Business Judgment Rule and arguing that its Board rightfully denied the purchases of the Unit because there were comparable apartments that were sold at higher prices. The Court denied the Defendant Corporation's motion for Summary Judgment. The Court found that the "Plaintiff provide[d] a showing that the Board may have engaged in self-dealing by denying the application and basing this denial on the sales price being too low, when the Board had previously offered [to purchase her apartment] at the price of $400,000.00. The Board's offer was much less than the Purchasers' initial offer of $495,000.00 [which was denied]." The Court held that "…issues of fact remain[ed] as to whether or not the Board engaged in self-dealing because they had an interest in purchasing [the Plaintiff's] Unit. The issue can only be further developed through the discovery process, therefore this motion for summary judgment is premature." While it is rare that the courts find against a Corporation or Cooperative Board when it comes to the Business Judgment Rule, the judge here has decided that this case should proceed.

Can the Business Judgment Rule Coexist with the Co-op Act?

The New York State Court of Appeals, being the highest court in the State of New York, affirmed 17 years ago, that "the "business judgment" rule is the correct standard of judicial review for the actions of the directors of a cooperative corporation. *Levandusky v. One Fifth Ave. Apt. Corp., 75 N.Y.2d 530, 554 N.Y.S.2d 807, 553 N.E.2d 1317 [1990]*. The business judgment rule, when used properly, is an effective standard to govern corporate boards. The rule prohibits judicial inquiry into the actions of corporate directors "…taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.'"

While those opposed believe that the enactment of the Co-op Act will serve to restrict or limit the Business Judgment Rule and even cause its demise, it is clear that both can co-exist. The Co-op Act's main goal is to expedite the approval process and provide objective standards to be used when rejecting or approving a prospective homeowner. The Business Judgment Rule is not to be used as a tool to hide reasons why an applicant should or should not be approved. And, while the Business Judgment Rule is a legitimate theory and corporate tool, housing and denial of housing based on it should not be permitted. The Business Judgment Rule actually

provides cooperative corporations with a way to violate the Fair Housing laws without anyone knowing. The enactment of the Co-op Act will simply force cooperative boards to establish an objective list of standards which in many instances may actually curtail litigation rather than increase it.

In its 2016 Memorandum, NYSAR stated that, "…these benchmarks will prevent any appearance of impropriety, be it real or perceived, on behalf of cooperative boards. It is essential that the process of purchasing a cooperative dwelling include additional safeguards to protect against illegal discrimination." The opponents of the law must realize that the Co-op Act does not take away the rights of the Business Judgment Rule, but protects prospective homeowners in their quest of home ownership. REALTORS®, as pioneers of fair housing rights must forge ahead in solidarity in continued support for the Fairness in Cooperative Home Ownership Act and continue to support transparency.

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