

LAW AND LEGISLATION

Board Denials on the Rise *Is There Anything Buyers Can Do?*

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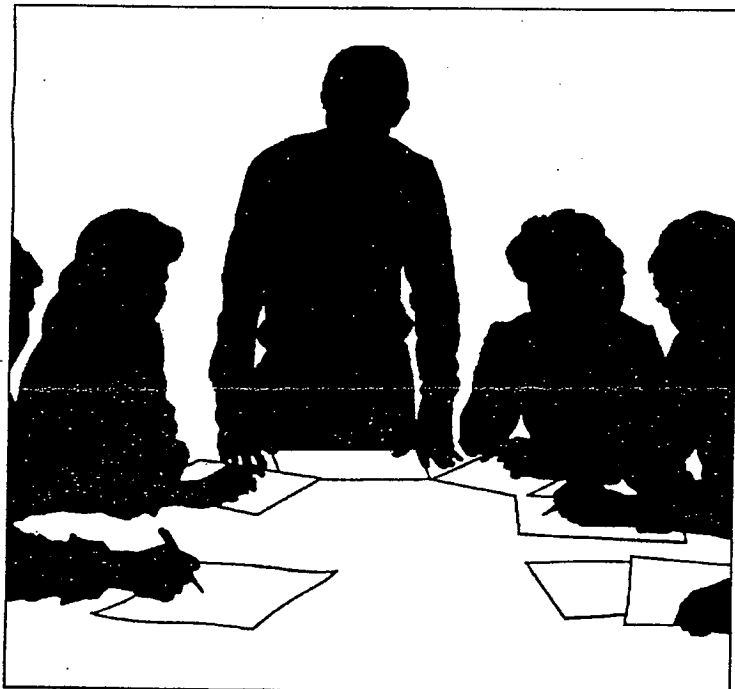
As the resale value and demand for cooperative apartments increase and the supply of available units decreases, purchasers are facing denials for admission to co-op buildings in record number. There was a time when many co-op boards concluded that if a bank had given a prospective buyer a loan, the board would consent to the sale of an apartment. Co-op boards have since become much more selective about their future neighbors.

The first concept that all sellers and prospective owners of a co-op apartment must grasp is that

from those who do not fit the financial and social profile of a building. Unless specifically excepted with exact language in the proprietary lease, a transfer of shares to an apartment cannot take place without board consent.

The Business Judgment Rule

It has long been the recognized rule in New York State that generally a court will not question the decisions made by the board of a private corporation. This concept of non-judicial review has been referred to as the "business judgment rule." New York courts have applied the business judgment rule to co-op boards, thereby



Co-op boards have great freedom in selecting future neighbors, provided they don't exercise discriminatory practices in the approval process.

cooperative ownership is inherently different from that of "fee" ownership in which the owner has an interest in real property. Co-ops were created to promote stability in a building and accordingly, a co-op board can determine who may or may not become a shareholder. Co-ops can use the scrutiny of reviewing prospective purchasers' applications as a way of protecting the shareholders

granting them great discretion in deciding whether to approve or deny the sale of an apartment. Co-op board discretion has been clarified in a landmark case decided in 1990 entitled *Levandusky v. One Fifth Avenue Apartment Corp.* The *Levandusky* case set forth the following guidelines that a co-op must follow in order to withstand the judicial review

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of the courts; The board's actions must be (i) in furtherance of the purpose of the co-op; (ii) within the scope of its authority; and (iii) in good faith.

This three-prong test essentially shifts the burden of proof from the defending co-op board to the challenging party. The rule set forth in *Levandusky* does not automatically bar judicial review of the board action provided the plaintiff can demonstrate that the board acted for a purpose other than that for which the co-op was formed, beyond the scope of its authority or in bad faith. If the plaintiff is successful in meeting this threshold, the court will hear the case and the burden of proof will then shift back to the board. Seven years later, the courts still look at the *Levandusky* case as a guideline to shareholder actions against co-op boards.

In determining if a board has exceeded its authority, a court will review the co-op's governing documents for explicit authorization of the board actions. These documents include the certificate of incorporation, by-laws and the proprietary lease (see "Your Rights and Obligations," page 21). Most leases provide that the transfer of shares and lease to a new tenant/shareholder must be made with the consent of the board. Some leases provide for no approval and, in the event of a denial, the lease should be reviewed to determine if the board acted beyond the scope of its authority.

Improper Board Action

If a board exercises discriminatory practices in its approval process, a court may review improper board action. If a denial is based on race, creed, color, sex, age, religion or disability, the prospective purchaser or owner cannot merely allege discrimination but must meet the burden of proof. In a recent case, *Simpson v. Berkley Owner's Corp.*, the Appellate Division of New York determined that, absent illegal discrimination, the co-op board has the right to deny a prospective shareholder's application for a purchase of an apartment for "any reason or no reason." In this case, the co-op's denial of a purchase application was upheld. The court stated that unless the plaintiff could submit evidence that the board did not act in the best interests of its shareholders, the court need not

review the case. The *Simpson* case puts a tremendous burden on the prospective purchaser who feels that his or her denial is discriminatory. The buyer must obtain sufficient evidence that the board's actions were predicated on a discriminatory practice, a task that can be time-consuming and very costly.

A board can determine, at its own discretion, whether the application of a prospective purchaser reflected that he or she cannot meet the financial obligations of owning a co-op apartment. In addition, a board can decide if the purchaser intends to occupy the apartment or merely to sublet it. While a purchaser may believe there are discrim-

Conditional Approvals

Many co-op boards have imposed additional financial conditions as a prerequisite to approving the sale of an apartment. Typically, a co-op board will impose a financial condition on a prospective purchaser when there is concern about the buyer's ability to pay for the maintenance and the carrying charges of a loan. As previously pointed out, New York law allows a board to restrict a sale provided that any additional conditions are not made in "bad faith" or are not discriminatory. The three most frequent conditions imposed on a prospective shareholder are: (i) a guarantee from a relative or third party to ensure that main-

New York courts have prohibited two types of financial limitations: imposed by co-ops, even if they apply equally to all shareholders. A co-op cannot require that sales be approved only if the shares are sold for a minimum price nor can a co-op require that a shareholder settle all claims or litigation with the co-op before the board approves the sale of an apartment.

In 1995, a New York court determined that a co-op board cannot set a minimum sales price policy stating that such a rule was outside the scope of a board's authority and that it was an unreasonable restraint on the transfer of apartments. While the co-op set this rule to protect the value of the property and contended the decision to set minimum sales prices was protected by the *Levandusky* case, the court held that the co-op overreached its authority.

Delays in Approval

The standard contract of sale provides that if a co-op board has not made a decision to approve or deny a purchaser by the closing date set forth in the contract of sale, the closing is automatically postponed for 30 business days for the purpose of obtaining board approval. If the approval is not obtained by the postponed date either the seller or the purchaser has the right to cancel the contract.

Frequently, the purchaser does not want to cancel the contract. Nevertheless, as a way of putting pressure on the board, the purchaser's attorney can write a letter to the seller's attorney stating that in the event a co-op meeting is not scheduled within a certain time frame, the purchaser will exercise the right to cancel the contract. The seller's attorney can then forward this letter to the board, requesting that an interview be set up before the board causes the transaction to fold.

Co-op corporations continue to decide for themselves with whom they wish to share their homes common areas, meetings, rules and responsibilities. New York courts have given boards great discretion in deciding to approve or deny the sale of apartments, provided that such decisions are not discriminatory. It is up to the boards to make sure that they adhere to building policy when making decisions and to establish an approval process that benefits the entire building. ■

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inatory overtones, the reality is that co-op boards do not have to disclose why a prospective purchaser has been denied admission.

The "good faith" element of the three-prong *Levandusky* case focuses on the fiduciary relationship between the co-op board and its shareholders. Similar to discrimination cases, when bad faith is alleged and backed by solid evidence, the courts will review the board's actions but such review will not guarantee the outcome of the case.

Many prospective purchasers swallow their pride after a co-op board denial and move on. Most feel that it is not appealing to sue the people that you may be sharing a home with and most do not pursue the purchase of a co-op once denied. For the seller, the harm may be even greater; after making plans to move, taking the apartment off the market for weeks and many times, months, possibly even entering into a contract to purchase another home, the seller must start the process all over again with no remuneration.

tenance fees are paid on time; (ii) a deposit or "escrow" of maintenance covering anywhere from one to three years of maintenance to be used in the event that maintenance is not paid; and (iii) insisting that the purchaser reduce the amount of money being borrowed so as to reduce monthly carrying costs.

The board can impose any combination of these three conditions or all of them. If a purchaser has been denied for no apparent reason, the seller can suggest that the board impose any or all of these conditions if the purchaser wants to proceed with the transaction. Otherwise, the purchaser will most likely cancel the contract and can obtain a refund of the downpayment.

Some Restrictions Are Prohibited

It is prohibited for a co-op to impose unique restrictions on different purchasers. If a properly adopted co-op by-law or resolution imposes financial conditions, such a policy is acceptable provided these conditions apply to all shareholders and/or prospective purchasers. However,