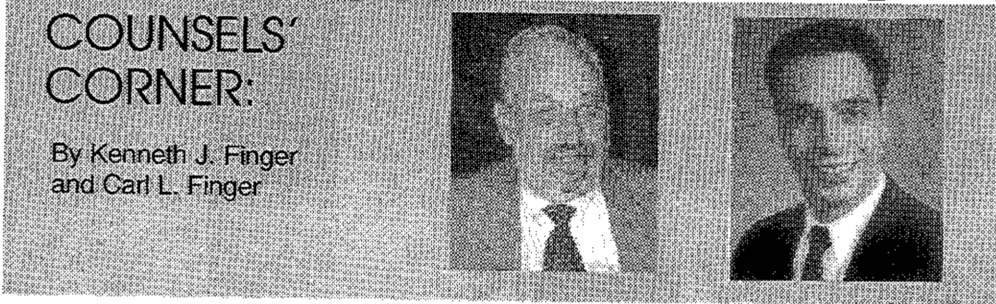
Price as a Consideration in Cooperative Applications



COUNSELS' CORNER:

By Kenneth J. Finger and Carl L. Finger

WHITE PLAINS - Perhaps the single most significant responsibility to fall upon a cooperative's Board of Directors is the responsibility of reviewing applications to purchase shares and reside in the cooperative.

In agreeing to permit a person to purchase stock and reside in a unit at a cooperative, the board is agreeing to permit that person to become a member of the community, with all of the rights and obligations imposed upon a member of the cooperative community.

Additionally, the terms of the purchase may impact the cooperative from a financial and economic perspective. Thus, many cooperatives regulate the amount of financing permitted against the shares and lease, as well as other financial requirements relative to the proposed purchaser.

In this vein, the issue of sale price as a consideration in whether to approve or disapprove a purchaser deserves scrutiny. Many Boards of Directors enunciate a concern that if the sale price of a unit is far below the reasonable value of the property, then the result will be the devaluation of other units in the cooperative.

This concern is certainly legitimate, given that the common manner for valuing units is the price paid for similar units on prior sales. The valuation by prior sales is particularly significant in circumstances where purchasers obtain financing to purchase units and the lender does an appraisal which relies, in some part, on prior sales in the cooperative.

In such a circumstance, one "low" sale can devalue future sales.

Judgments

Generally, a cooperative's Board of Directors may exercise its business judgment in determining whether to approve or disapprove any application, *Levandusky v. One Fifth Ave. Apartment Corp., 75 NY2d 530.*

The "business judgment rule" generally protects decisions by a Board of Directors from review thereof, unless there is an allegation that the board acted in bad faith or in a discriminatory manner. The question as regards to sale price may thus be confined to whether, in considering sale price, a board is acting in a bad faith or in a discriminatory manner.

In *Oakley v. Longview Owners, Inc.*, Id, the Westchester Supreme Court addressed this matter. In that case, the Cooperative had instituted a policy wherein it imposed an absolute floor on the price that would be approved for the sale of an apartment. The court held that such a restriction constituted an "open-ended and potentially long-lasting prohibition," Id.

The Court held that although "corporate shares may be reasonably restrained in terms of the alienability...the floor price resolution, as adopted, is a prohibition of transfer and is an unreasonable restraint of alienation," Id.

Thus, the Court in *Oakley v. Longview Owners, Inc.*, Id., held that a strict price minimum would be an impermissible restraint on alienation and therefore was not legal. While that case might be viewed negatively in regard to the board's powers, certain non-legal factors were present that may have swayed the court.

Another Scenario

The issue was similarly addressed in the matter of *Marine Midland Bank v. White Oak Cooperative Housing Corp. NYLJ, 3/19/97, P. 31, Col. 5.* In that matter, the Cooperative prevailed in the case. However, the Cooperative did have a requirement that units be sold at a price set by the Cooperative in order to be approved. The Court held, based on Oakley, that this restriction was "an unreasonable restraint on alienation" and that the Cooperative "has no right...to restrict the price. Such a right is also not implicit under the defendant's [Cooperative's] right to approve a third-party purchaser, as the price to be paid has nothing to do with the person,"Id.

Although the Cooperative prevailed in that case, the language used by the court nonetheless indicates not only that a set price would be problematic, but also that the price was a distinct issue and not to be considered relative to the purchaser's application.

However, since this language was not relevant to the actual decision by the court that favored the Cooperative, it should not be construed as determinative of the issue.

Moreover, we believe that had this matter been appealed, the quoted language, were it relevant, would have been modified, or reversed, in view of the nature of White Oak as a Section 213 cooperative that purchased back its own shares and then sold them itself.

Another Price Issue

In the matter of *Levine v. Yokell, et al, NYLJ, P.26, Col. 5*, the Plaintiff was a potential purchaser of a cooperative apartment. The Plaintiff claimed that her application was denied as a result of the price to be paid pursuant to the contract of sale and because the defendant board members were concerned that the value of their own units would be detrimentally impacted because of the low price of her sale. She alleged that this was an improper basis to deny her application and sued the Board for damages.

The Court dismissed the action, which claimed tortious interference with contractual relations, finding that the "defendants' acts were based on economic considerations, not merely an unjustified intent to harm," Id, which would have been required to establish the claim asserted by the Plaintiff, the prospective purchaser.

It may be difficult to synthesize a consistent rule of law from these various cases. However, *Levine v. Yokell*, a higher court than either of the Westchester cases, limits the ability of a prospective purchaser to seek a remedy against the Cooperative and allows for the consideration of price as a defense to the type of action brought. Thus, it seems that consideration of price is a legitimate factor for a Board to consider when reviewing an application. However, as with the other cases, this finding is not critical to the ultimate result and thus of potentially limited value.

To the extent one can discern a rule of thumb in these cases, it can fairly be stated that the Courts have not frowned upon the consideration of economic issues, i.e. price, but have been negatively impressed when economics is not considered but dictated by a set price.

The use of a set price seems to indicate that consideration is not being given to the issue because the hard and fast rule precludes any meaningful consideration of a price that does not meet the criteria previously established. Thus, one can glean a rule that a set price or set floor is bad, while general consideration of price is acceptable.

Finally, it is worth noting that, as with all such discussions, and as specifically referenced by the Court in *Marine Midland Bank v. White Oak Cooperative Housing Corp.*, supra, the corporate documents - including the proprietary lease, occupancy agreement and by-laws - may play a significant role in any determination of this matter in a specific circumstance, and it would always be wise to consult those documents and the corporation's legal counsel before formulating a complete opinion.

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Editor's note: IMPACT is happy to publish the inaugural Counsels' Corner. Kenneth J. Finger, Esq., is chief counsel to the Building and Realty Institute of Westchester and the Mid-Hudson Region (BRI). He is also a principal of Finger and Finger, A Professional Corporation, of White Plains. Carl L. Finger, Esq., is also with Finger and Finger.

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Industry Participates in Annual Guidelines Process

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"The combined net effect for insurance to an owner of apartments in Westchester County has been approximately 35 percent to 40 percent more for the same coverage than one year ago," Levitt said.

Energy

Herb Rose - an energy consultant to the Building and Realty Institute (BRI), an affiliate organization of the AOAC - emphasized the steep increases owners are facing in energy costs.

Rose stressed that the price of natural gas in recent months has tripled. The price, he said, impacts the cost of electricity and heating oil.

A realty industry study of buildings in Westchester, Rose said, showed increases in energy costs ranging from 14 percent to 72 percent.

"This is a very worrisome situation, because this is not the end of energy price escalation," Rose said. "We're all in the same boat – conditions that hurt landlords will ultimately impact tenants. Some reasonable rental increase is in order for everyone's protection."

Labor

Owners of rental buildings are also facing noteworthy increases in labor expenses, according to Matt Persanis, labor counsel to the BRI and AOAC.

With the labor contract between the BRI and Local 32/BJ Service Employees Union expiring on Sept. 30, Persanis said owners can expect to see an increase in labor costs similar to the recent contract rises in Manhattan (4.7 percent per year) and the Bronx (4.6 percent per year). The Westchester hikes, he said, will likely run over a three-year contract.

Other Factors

Realty industry representatives addressed the other increases in owners' expenses at the guidelines board's public hearing in White Plains on June 5.

The speakers included:

•Saul Gluckman, chairman, BRI, Major Capital Improvements (MCI's) and depreciation.

•Ken Nilsen, chairman, AOAC, overall industry presentation.

•Dan Singer, Robison Oil, heating oil.

•Tom Spitznas, economist, property taxes.

The board is scheduled to adopt new guidelines at its June 25 deliberation at the Westchester County Courthouse in White Plains. A second deliberation, if needed, is set for June 26 at the county courthouse.

The AOAC represents more than 300 owners and managers of rental apartment buildings and complexes in the Westchester and Mid-Hudson region. Those owners are responsible for more than 20,000 units, association officials said.