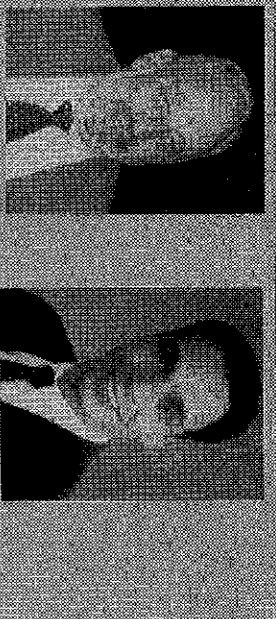


COUNSELS' CORNER:

By Kenneth J. Finger
and Carl L. Finger



Pulman and the Business Judgment Rule: Don't Forget to Go to Court

WHITE PLAINS - The decision of the Court of Appeals in May 2003 in the case of 40 West 67th Street v. David Pulman caused a general celebration among cooperative boards of directors throughout New York State.

However, the jubilation associated with the decision must be tempered with a close look at the language of the decision and the practical considerations associated with the evaluation.

Preliminarily, the factual circumstances which gave rise to the Court of Appeals decision warrant some discussion. First, the shareholder's lease in that case was terminated after a long history of well-documented, egregious behavior, followed by a vote of the shareholders directing the board to terminate the shareholder's lease.

The Board followed the directions of the shareholder vote and subsequently commenced an action to eject the shareholder and gain possession of the apartment.

The Court of Appeals heard the case relative to the issue of whether the board of directors' decision to terminate the lease was entitled to deference under the "Business Judgment Rule" enunciated in *Levandusky v. One Fifth Avenue Corp.* (75 NY2d 530, [1990]), or whether the decision was required to be supported by competent evidence established to the reviewing Court.

This determination was not an obvious one as demon-

strated by the fact that the trial court had decided that the cooperative did in fact need to establish the objectionable conduct by such proof to the Court. The Appellate Division, and thereafter the Court of Appeals, held that the decision was entitled to deference under the business judgment rule.

An Important Inspection

That conclusion, however, warrants careful inspection to understand its implications. The Court specifically held that "the business judgment rule may be applied consistently with the statute [RPAPL 711(2)]."

Thus, the Court was not eliminating the consideration of the factors that might lead to a termination of a lease in the cooperative, but asserting that it would give deference to the facts under the business judgment rule.

The Court held that "the competent evidence that is the basis for the shareholder vote will be reviewed under the business judgment rule, which means courts will normally defer to that vote and the shareholders' stated findings as competent evidence that the tenant is indeed objectionable under the statute."

Notably, the Court went on to find that "relationships among shareholders in cooperatives are sufficiently distinct from traditional landlord-tenant relationships and that the statute's "competent evidence" stan-

dard is satisfied by the application of the business judgment rule."

Exceptions

However, the Court also

"Thus, when terminating leases, cooperative boards must remain careful to act judiciously."

carved out three exceptions wherein the Court may undertake greater investigation.

Those circumstances are when such an evaluation might transpire upon a showing by the shareholder that "the board acted (1) outside the scope of its authority, (2) in a way that did not legitimately further the corporate purpose or (3) in bad faith." Thus, a board making a determination to terminate a lease, or any other decision for that matter, must take care not to run afoul of these limitations.

As to the scope of the board's authority, care must be taken to insure that the proprietary lease, by-laws and house rules provide the authority to take the action in question, like terminating a lease as in this case. The lack of appropriate

legal authority may result in a Court's looking beyond the business judgment of the board and scrutinizing the factual basis for the decision.

As to the corporate purpose, the Court held that there must be a "legitimate relationship between the board's action and the welfare of the cooperative" and that "all the shareholders of a cooperative may agree on an objective, but that does not necessarily mean that the objective is lawful or legitimate."

Thus, there are two elements to the "corporate purpose exception" set forth by the Court of Appeals, a legitimate goal and rational relationship of the action to the goal.

Finally, the Court held that the singling out of one party for "unlawful discrimination, vendetta, arbitrary decision making or favoritism" would be "incompatible with good faith and the exercise of honest judgment."

Not a "Rubber Stamp" Process

Importantly, the Court went on to state that "while deferential, the Levandusky standard should not serve as a rubber stamp for cooperative board actions, particularly those involving terminations." Thus, in

the event of evidence of a lack of good faith, a board may certainly expect further scrutiny by the Court.

In view of all of the previously mentioned material, the Court found that the board in the Pulman case was entitled to deference and the application of the business judgment rule. But, it did not negate the requirement that a board attend Court after termination to eject the shareholder. This important step cannot be overlooked as the requirement that Court proceedings be utilized to evict a shareholder after termination means that the Court will look to see that the board had authority, legitimate goals and exercised good faith in the termination of the lease.

Significantly, the Court of Appeals stated that "when dealing, however, with termination, courts must exercise heightened vigilance in examining whether the board's action meets the Levandusky [business judgment rule] test."

Thus, when terminating leases, cooperative boards must remain careful to act judiciously, so that the Court that a dispute finds its way into will be inclined to pay the board deference due deference under the business judgment rule.

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Reviewing a Mixture of Industry Conditions

WASHINGTON - A new year, but the same strong pace.

That's been the story for the national home building sector through January, according to a recent building and realty industry report from the National Association of Home Builders (NAHB).

As an indication that single family home builders perceive conditions in the new-homes market to be close to the favorable levels of last year's record-breaking sales and production activity, NAHB's monthly gauge of builder confidence for January is down just slightly from December, the study said.

The upbeat approach, in more good news, is poised to rise again on the latest downshift in mortgage rates, the report added.

THE HANLEY REPORT
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NAHB's Housing Market Index (HMI), which was released earlier this month at the International Builders Show in Las Vegas, fell two points to 68 in January, still well ahead of its 64 reading at the start of 2003, according to the study.

"Coming off the best year in history for single family home sales and production, builders are set for another very busy year in 2004," said NAHB President Kent Conline. "There's plenty of momentum in this marketplace."

David Seiders, chief economist for NAHB, agreed with that assessment, adding that the overall outlook is "quite upbeat." "Keep in mind that the January HMI survey was taken before the latest downshift in long-term mortgage rates, so there

is good upside potential for this measure heading forward," he said.

The average rate, the report said, on 30-year mortgages fell from an already attractive 5.85 percent in early January to an even more favorable 5.66 percent earlier this month.

The HMI is derived from a monthly survey of builders that NAHB has been conducting for nearly 20 years. Home builders are asked to rate current sales of single family homes and sales expectations for the next six months as "good," "fair," or "poor."

Builders are also asked, the report said, to rate the traffic of prospective buyers as "high to very high," "average" or "low to very low." Scores for responses

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