

HABITAT

BOARD OPERATIONS

The Armor of the Business Judgment Rule Can Be Pierced

Ira Brad Matetsky in [Board Operations](#) on February 28, 2019

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Under most proprietary leases and applicable law, **cooperative boards** are free to disapprove an application to purchase a unit for any reason or no reason – so long as the board does not act for an unlawful reason, such as **discrimination** against one of the city’s numerous “**protected**” classes. Therefore, lawsuits challenging a

board's rejection of an application are generally dismissed without a trial. However, "generally" does not mean "always." A recent lawsuit illustrates the point.

The lawsuit was brought by the tenant-shareholder of a ground-floor unit in the cooperative at **420 East 72nd Street** on the Upper East Side. According to the facts set forth in a lower court's opinion, the board of directors had expressed interest in purchasing the unit to create a gym. After some time elapsed without confirmation that the board wished to pursue the purchase, plaintiff listed the unit for sale for **\$499,000**. Two weeks later, the board offered **\$400,000** for the unit, which plaintiff declined as being below market value.

Plaintiff then received an all-cash **\$495,000** offer from a third party and entered into a contract. The co-op's managing agent advised the shareholder that the sale had not been approved because the board felt the sale price was "under market value" – and that a re-application with a price of at least **\$535,000** would be considered.

The shareholder and prospective purchasers agreed to amend their sale contract to increase the price to **\$535,000**. The shareholder also obtained an appraisal, which reflected a market value of **\$525,000**. The board responded by requesting that the purchase price be further increased to **\$610,000**. Now the seller sued the cooperative and its board members, alleging that they had acted in **bad faith** and were guilty of **self-dealing**.

The board and the individual directors moved to have the case dismissed based on the **Business Judgment Rule**, which insulates most board decisions from judicial review. They argued that there was no evidence of discrimination, self-dealing, or misconduct. They also contended that the rejection was based on the low purchase price for the unit compared to recent sales of other units in the building.

The trial court's decision acknowledged that board decision-making is typically protected by the Business Judgment Rule. However, in this case the plaintiff presented a sufficient basis for judicial review of the board's decision. Why? Because, according to the court, "the board may have engaged in self-dealing by denying the application and basing the denial on the sales price being too low" – when the board had offered to purchase the unit at an even lower price. Also, the board rejected the application even after the price had been increased to the level the board requested.

The defendants appealed. The appellate court agreed with the lower court that, insofar as the claims were asserted against the co-op itself, the plaintiff had "presented sufficient evidence to raise a triable issue of fact as to whether defendant cooperative board rejected the offers to purchase the subject unit in bad faith and for purposes of **retaliation**." However, the appellate court dismissed all claims against the board members individually, finding that the cooperative corporation was the only proper defendant.

A lesson of this case is that a board must be especially carefully in

considering a purchase application for space that the board has sought to acquire for common use. Even if the board's interest to acquire the space is for the benefit of all shareholders rather than the directors' individual interests, such a proposal may lead the court to treat the board of directors as, in essence, a **competing bidder** for the space rather than as a **disinterested decision-maker**.

The Business Judgment Rule is an imposing suit of armor for co-op boards. But like any protection, it has its limits, and it can be pierced.

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