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MEMORANDUM

TO: Clients and Friends

FROM: Jason LoMonaco and Howard Schechter

RE: Objectionable Behavior: The Pullman Case

DATE: July 11, 2003

The New York Court of Appeals, New York's highest court, has recently made it easier for a cooperative to evict a tenant-shareholder who engages in objectionable conduct. In the case, 40 West 67th Street Corporation v. Pullman, the Court ruled that courts cannot second guess a cooperative's determination that a shareholder's conduct is objectionable provided the proprietary lease gives the coop the right to make such a determination and provided all applicable procedures are followed.

The problem with these kinds of evictions has been that courts required coops both to prove the particular conduct that the shareholder engaged in and then to establish to the satisfaction of the court that the conduct was indeed objectionable. The mere fact that the other shareholders objected to such behavior was not enough. As a result of Pullman, courts will now apply the doctrine known as the "Business Judgment Rule" to cooperative determinations involving objectionable conduct. This is an extension of the long established practice of granting corporate Boards great deference when they are deciding how to conduct their business. Accordingly, subject to certain limitations discussed below, courts may no longer question the underlying validity of a cooperative's determination that a shareholder has engaged in objectionable conduct and the cooperative's determination will stand.

Contrary to reports in the mainstream press, a coop seeking to evict a shareholder for objectionable conduct must still go to court. However, the court proceeding will be limited to certain procedural issues discussed below.

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Requirements for eviction of an objectionable shareholder:

First and foremost, in order for a cooperative to evict an objectionable shareholder without court scrutiny, the proprietary lease must give the coop the right to **determine** what constitutes objectionable conduct. A lease that merely prohibits objectionable conduct without granting the coop the right to "determine" what constitutes objectionable conduct will not protect a coop's decision from court scrutiny. Mr. Pullman's lease provided that the coop could terminate his lease upon the "**determination**" of two-thirds of the shareholders that he engaged in objectionable conduct. Thus the coop reserved the right to determine what conduct is objectionable.

Secondly, a coop must comply with all of the notice and procedural requirements of its lease and by-laws. In accordance with its lease and by-laws, Mr. Pullman's coop scheduled a shareholder meeting for the stated purpose of holding a vote on whether to terminate his lease based on alleged objectionable conduct. Mr. Pullman received the notice but chose not to attend the meeting. The Board of Directors presented a resolution at the meeting which contained specific findings of fact against Mr. Pullman. The shareholders adopted the resolution by a greater than two-thirds majority. The Board of Directors then issued a Notice of Termination, and after Mr. Pullman failed to vacate his apartment an eviction case was commenced. All of the cooperative's actions were held by the Court to be in compliance with the lease and by-laws.

Limitations on objectionable conduct evictions

In ruling that the cooperative has such significant and unreviewable authority, the Court also recognized that a coop could overstep its bounds. The Court stated that a shareholder can challenge a cooperative's determination, and a court may properly review such decision, only when the shareholder proves that the coop acted improperly in one of the following ways:

1. The coop exceeded its authority; or
2. The coop's action did not reasonably further a corporate purpose, or did so illegitimately; or
3. The coop acted in bad faith.

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Despite the great deference that will be given to a cooperative's determination of objectionable conduct, the Court strongly cautioned courts not to "rubber stamp" such determinations and specifically directed them to exercise "heightened vigilance" in scrutinizing coop determinations for any of the three prohibitions listed above.

In Pullman, the shareholder failed to establish any of the three potential objections. The "objectionable conduct" provision in the proprietary lease authorized the shareholders to find Mr. Pullman undesirable and was clearly followed. The determination furthered the corporate purpose of promoting a congenial living environment for other shareholders (a legal and legitimate corporate purpose) and there was no evidence of bad faith in the form of favoritism, discrimination, a vendetta, or arbitrary decision making. As a result, the Court deferred to the will of the cooperative and saw no reason to interfere with its determination.

Scope of Pullman

Many cooperatives utilize a proprietary lease which contains an objectionable conduct provision authorizing the coop to determine objectionable conduct on the part of a shareholder by a vote of the Board of Directors only. It is not entirely clear that Pullman protects such a determination from court scrutiny based solely on a vote of the Board.

In its decision, the Court highlighted the safeguard inherent in the two-thirds shareholder vote called for in Mr. Pullman's lease. The court conspicuously referred to the "collective will" of the Coop and ruled that the shareholder vote constituted competent evidence that Mr. Pullman was indeed objectionable. This leaves open the possibility that a Board determination of objectionable conduct without a shareholder vote will not be given the same level of deference. Judges may attempt to limit Pullman to leases that require shareholder votes because there was such a vote in that case.

On the other hand, the Court referred to numerous precedents that involved determinations by Boards of Directors, as opposed to shareholders, and expressed its approval of the actions and determinations of Mr. Pullman's Board. Thus courts may accept determinations made solely by a cooperative Board of Directors without a shareholder vote.

Finally, the Court noted that Mr. Pullman's coop had given him a chance to explain his side of the story at the shareholders meeting: an opportunity he chose not to take.

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Although there is no statement that the Court requires that such notice and opportunity be given (unless specifically required in the lease or by-laws of course), its deliberate mention suggests that an opportunity to challenge the charges should be a component of any action to terminate a lease based on objectionable conduct.

Pullman provides many cooperatives with a new and less cumbersome means of evicting shareholders who exhibit objectionable behavior. Time will tell how far-reaching this decision is and whether trial courts are willing to extend the principles of this decision beyond the particular facts that led to the eviction of Mr. Pullman.