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Proprietary Lease 'Trumps' Business Judgment Rule

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Anyone who practices in the area of cooperative apartments is likely familiar with the "business judgment rule." In the seminal case of *Levandusky v. One Fifth Ave. Apt. Corp.*[1] the Court of Appeals held that the "business judgment rule" applicable to business corporations also applies to cooperative boards, and as applied prohibits judicial scrutiny of actions of cooperative boards taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes. The business judgment rule provides that a court should defer to a cooperative board's determination "[s]o long as the board acts for the purposes of the cooperative, within the scope of its authority and in good faith."[2]

A recent decision that made for a very interesting read from Justice Arthur F. Engoron of Supreme Court, New York County in *Kaplan v. Park South Tenants Corp.*,[3] held, in granting a preliminary injunction in favor of the shareholder, that the business judgment rule did not shelter the cooperative from the court's review as to whether the cooperative acted reasonably in refusing to consent to the shareholder's proposed alterations.

'Kaplan'

The facts as recited by the court in *Kaplan* are as follows. The shareholder Michael Kaplan was a 73-year old man who resided in a cooperative apartment and "suffered from certain cardiovascular conditions that require him to reside in an adequately cooled residence." The shareholder desired to perform certain alterations to (1) "install an 'exterior' air conditioning…system, including placing three condenser units on the (arguably) private terrace adjoining plaintiffs' apartment and creating a two inch (diameter?) hole in an exterior wall to connect it to the interior components; and (2) relocate a telecommunications conduit from the center of plaintiffs' bathroom to the wall."

> Cooperative boards cannot necessarily rely on the protection of the "business judgment rule" to insulate its determinations from court review.

The subject proprietary lease for the apartment provided that "any alterations, including the ones at…issue" may not be made without the board's "'prior written consent,' said consent not to be 'unreasonably withheld.'" Thus, on or about Jan. 30, 2014, plaintiffs requested that defendants consent to the aforesaid work. The cooperative corporation denied consent based upon, among other things, one of the "house rules" which specifically provided that "[o]nly outdoor designated tables, chairs and planters are permitted on balconies…No other items are permitted." The proprietary lease expressly stated that a shareholder's use of a terrace was "subject to such regulations as may, from time to time, be prescribed by the Directors."

The cooperative corporation also based its refusal on the fact that the alteration work was "contrary to longstanding board policy" and that to allow the work would "set a precedent for similar applications."

The plaintiffs moved for a preliminary injunction under CPLR Article 63 seeking to enjoin defendants from "'taking any action to prevent Plaintiffs from installing three Dalkin air conditioning condenser units on the private terrace that adjoins Plaintiffs' apartment and taking any action to prevent Plaintiffs from relocating a telecom riser that runs through the center of Plaintiffs' bathroom to the wall of the bathroom.'"

In support of the motion, the plaintiffs contended that the board's refusal to consent to the requested alterations was unreasonable. Among other things, the plaintiffs established through the affidavit from an engineer that the air conditioning system that currently existed did not adequately cool the unit due in part to "three factors that are unique to the unit;" namely, (1) the building's heating and hot water pipes run directly below plaintiff's floor and emit radiant heat, (2) that "' most of the air intake vents in the unit have been sealed by [the cooperative],'" and (3) "that because the apartment is so large, 'an average air conditioning system'" would be inadequate.

The plaintiffs further provided an affidavit from an "a/c expert" stating that the condensers that the plaintiffs sought to install were "small, lightweight, state-of-the-art… units that…make virtually no sound at all, as they are equipped with internal vibration isolation pads that eliminate any vibration or sound" and that the units "will not be visible to, or otherwise adversely affect, any other resident of the Building."

The "expert" further stated that due to

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each unit's small size and light weight, the units "pose[d] no threat whatsoever to the structural integrity of the terrace on which they would sit." Finally, the plaintiffs maintained, and the cooperative did not "significantly dispute," that "an exterior a/c system has various advantages…over an interior system"—which interior system the cooperative was willing to approve—including that it is "easier to maintain," does "not take up otherwise-usable interior space," is "more powerful," poses "no threat of interior noise, vibration, or leaks…and there is no (or less) heat loss in winter." The plaintiffs also maintained that "'the Board has already permitted a different resident from the floor below plaintiffs to place her own condenser unit on our private terrace.'"

Business Judgment Rule

In opposition to the motion, the cooperative maintained, inter alia, that (1) the cooperative's decision to deny consent to the proposed alterations was protected by the business judgment rule, (2) the proposed alterations violated the house rules, which the cooperative explained was adopted after the cooperative was forced to spend $5 million to repair damage "caused by all manner of tenant misbehavior, including having 'installed private refrigeration equipment, heavy planters and heavy structures in which to house files and personal belongings' on terraces, balconies and roofs…," and (3) the requested injunction would improperly grant plaintiffs the "ultimate relief." The cooperative also argued that to make an exception to the house rules in this case would cause other shareholders to ask for the same thing.

By decision and order dated March 14, 2014, Engoron granted the plaintiffs' motion for a preliminary injunction and enjoined the cooperative corporation from taking any action to prevent plaintiffs from (1) completing the installation of the "exterior" air conditioning system at issue, (2) relocating the subject telecommunications conduit.

First, Engoron found that "the proprietary lease trumps the business judgment rule." Engoron relied on the decision of the Appellate Division, First Department in *Rosenthal v. One Hudson Park*,[4] which found that the business judgment rule did not "shelter[] from review" whether the cooperative corporation acted reasonably in imposing certain preconditions on the granting of consent to the shareholder's making of alterations.

Engoron then stated that the court "adopt[ed] plaintiffs' reasons and reasoning…as to why defendants' refusal to consent to plaintiffs' proposal is unreasonable." As to the plaintiffs' request to install the supplemental air conditioning, the court agreed with plaintiffs that, among other things, the shareholder was a 73-year-old man who suffered from cardiovascular conditions that required him to live in an adequately cooled residence, that the proposed air conditioning units make virtually no sound and would not be visible to or adversely affect any other resident, that the cooperative had already permitted a different resident to place her air conditioning unit on plaintiffs' terrace, and that plaintiffs' terrace was "already filled with other protrusions, and an additional protrusion will make no aesthetic difference."

> A "co-op board should not be able to run roughshod over rights previously established by contract."

In rejecting the cooperative's reliance on the house rules, Engoron stated that the proprietary lease "take[s] precedence over the House Rules, as the former predate[s] the latter, and 'first in time, first in right'" and that a "co-op board should not be able to run roughshod over rights previously established by contract." The court also found that "the Board adopted the House Rules pursuant to the business judgment rule, which… is subservient to the proprietary lease."

In any event, the court found that the plaintiffs were not seeking to violate the house rules, but only "asking that an exception be made."

The court also rejected the cooperative's contention that its refusal to consent was reasonable because otherwise other shareholders would be likely to make the same request for an exception to the house rules. Engoron explained:

> As best this Court can discern, defendants' main motivation in refusing permission and in defending this case…is the usual 'But what if everyone asks to do the same thing?' If that happens, the Board should do its duty to evaluate all requests objectively and fairly. The outcome may be that only one request is 'reasonable;' or that only five tenants, presumably the first five, can be accommodated; or maybe everyone can have a small condenser or two or three in the great outdoors. This Court has never seen the logic of denying a benefit to one person because not everyone else can have the same benefit, unless 'everyone else' is eight-years old. In any event, although defendants are attempting to 'address all tenants under the same rules, and do nothing more than treat the Kaplan apartment equally with the others,' plaintiffs and their apartment are not equal to everyone else, for the reasons discussed herein. (internal citations omitted).

Finally, in rejecting the cooperative's argument that the granting of the requested preliminary injunction would improperly grant plaintiffs' the ultimate relief, the court found that there would still be "something 'left to try' after compliance with [the] injunction: whether the Board's refusal is reasonable…." The court explained that:

> [i]f the Court determines that the refusal is reasonable, the Court can order plaintiffs to remove the condenser units from the roof and the piping from the wall, patch the hole, and reposition the telecommunications conduit. None of this remedial work would be time-consuming, dangerous, invasive or expensive.

Conclusion

Engoron's ruling means that cooperative boards cannot necessarily rely on the protection of the "business judgment rule" to insulate its determinations from court review, at least with regard to a board's determination to grant or refuse consent to alterations under a proprietary lease. As did Engoron, a court may make its own assessment as to whether a board's decision to refuse consent was "reasonable."

1. 75 N.Y.2d 530 (1990).
2. Id. at 538.
3. 2014 WL 1092445 (Sup. Ct. N.Y. Co. March 18, 2014).
4. 269 A.D.2d 144 (1st Dept. 2000).