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## EVICTING A SHAREHOLDER



### 40 WEST 67TH STREET CORP. V. PULLMAN

# Booted Out

BY GEOFFREY MAZEL

IT HAS BEEN NEARLY TWO years since the New York State Court of Appeals decided the matter of *40 West 67th Street Corp. v. Pullman*. Board members and professionals are still trying to determine its effects and whether it is as profound as first thought. What are the effects on cooperative boards and management today?

In *Pullman*, the cooperative board of directors brought an action against a shareholder seeking to eject the shareholder and recover possession based upon his "objectionable" conduct. In 1998, David Pullman bought a cooperative unit at 40 West 67th Street. Immediately after moving in, he engaged in

a course of conduct that was viewed by the board and many shareholders as disruptive and intolerable.

Pullman complained incessantly about his elderly upstairs neighbors. They were a college professor and his wife, who had occupied the apartment for 20 years without incident. Among other things, Pullman accused them of playing their television and stereo loudly into the night; cutting Pullman's telephone lines; running an illegal bookbinding business; and storing toxic chemicals in their apartment. Upon investigation, the board found all these allegations to be untrue and that these shareholders did not even own a television or stereo.

Later on, Pullman had a physical altercation with the

### BREAKING NEWS

After *Habitat* closed this issue in mid-December a decision was announced in *London Terrace Towers v. Davis*. It builds on *Pullman*, ruling that the board does not need shareholder approval to evict an undesirable shareholder. A full report will appear in the March issue of *Habitat*.

see over...

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retired professor and distributed a flyer to the cooperative residents in which he referred to the professor as "a psychopath in our midst." In another flyer, Pullman accused the board president and the professor's wife of having close intimate relations. Pullman wrote a stream of such letters.

Furthermore, Pullman made alterations to his apartment without board approval. In a breach of the house rules, he had the work performed on a weekend. He would not respond to the board request to correct these violations or to allow an inspection of the apartment.

Finally, Pullman began four lawsuits against his upstairs neighbors, the cooperative president, and the managing agent – and tried to start three more.

In response to this, the board of directors called a special meeting of the shareholders in an attempt to terminate Pullman's tenancy based on his objectionable conduct that was in violation of the terms of the proprietary lease. The resolution passed, with over 75 percent of the shareholders voting to throw him out.

This matter was litigated all the way to the New York State Court of Appeals, which issued its landmark decision on May 13, 2003. In its decision, the court upheld the shareholder's resolution to terminate the tenancy of Pullman.

The court's decision sent shock waves throughout the community of cooperative boards of directors, shareholders, and the professionals who work with them. Many thought this case gave boards unfettered discretion in dealing with problem shareholders. However, upon closer review of this case and several that have come more recently, it is clear that boards are still subject to standards and shareholders are protected from an arbitrary or capricious act by a board of directors.

Perhaps one of the most significant findings in *Pullman* deals with the way in which the court of appeals differentiated the termination of leases in traditional landlord-tenant settings from that in a cooperative setting. The court found that in situations involving shareholder termination, they will defer to the business judgment of the board. This is a significant departure from prior rulings that required boards to produce competent evidence to justify the shareholder's termination. Previously, the courts would make their own determination whether the shareholder's actions were objectionable. Essentially, the courts must now

defer to the business judgment of the cooperative when a shareholder is being terminated.

Still, *Pullman* offers very specific guidelines that a cooperative must follow when terminating a shareholder's proprietary lease. First, the lease must have a specific provision allowing for shareholder termination based upon "objectionable conduct." Second, the cooperative must unflinchingly follow its own procedures as specified in the bylaws. This will probably mean that a special shareholder meeting will be called and the issues will be deliberated in an open meeting. Proper notice of this meeting must be given to all shareholders. In addition, the vote will usually require a "super-majority" to pass. Many bylaws will require the approval of between 66 percent and 75 percent of the shareholders to terminate a shareholder's proprietary lease. Therefore, a thorough review of the proprietary lease and bylaws is critical in order to determine whether a cooperative has a "Pullman situation."

Moreover, the court in *Pullman* was well aware of the potential abuses by boards and shareholders. Therefore, even a shareholder vote to terminate may be reversed by a court if the cooperative acted outside its scope of authority. Consequently, the cooperative must follow its bylaws unflinchingly and give the shareholder an opportunity to be heard. It is up to the terminated shareholder to demonstrate to the court that the co-op acted outside the scope of its authority in terminating the tenancy.

The *Pullman* court also found the termination must further the corporate purpose. It stated that there must be a legitimate relationship between the board's action and the welfare of the cooperative. The court found that the terminated shareholder must demonstrate that the co-op's actions must further the cooperative's interests. If a shareholder has had a negative effect on all of the other shareholders, termination would further the cooperative's purpose. For example, if a shareholder has brought multiple frivolous lawsuits against the cooperative and cost the other shareholders thousands of dollars in unnecessary legal fees, the termination would benefit the cooperative and further the corporate purpose.

Additionally, the *Pullman* court found that the board must act in good faith in the exercise of honest judgment. Again, it falls on the terminated shareholder to show that the board

demonstrated bad faith, arbitrariness, favoritism, discrimination, or malice. If the terminated shareholder fails to raise facts revealing some sort of bad faith, the termination will stand. The *Pullman* court recognized the potential for abuse when a board singles out a shareholder and treats him or her with bad faith or acts in an arbitrary manner. Such an act by the cooperative will not be upheld.

The *Pullman* court clearly recognized the distinct nature of a co-op. The court stated: "The very concept of cooperative living entails a voluntary shared control over rules, maintenance, and the composition of the community." A shareholder voluntarily submits to the authority of a board of directors and the board "may significantly restrict the bundle of rights a property owner normally enjoys." In short, the court recognized the right of the cooperative to terminate a tenancy based on their objectionable conduct. As long as the cooperative has acted in good faith and within its authority, the cooperative decision may be upheld by the court.

A question cooperatives must battle over is how profound an impact *Pullman* has had on daily business. Some recent cases have shed some light on this. In *Woodrow Court Inc. v. Levine*, the court found that the *Pullman* decision did not apply to the case at bar since the shareholder termination was accomplished by a board, not a shareholder vote. Thereafter, in *Feld v. 710 Park Avenue Corp.*, the court ruled that the *Pullman* decision did not apply to a board bylaw amendment that precluded a shareholder who did not have a college degree from running for the board of directors.

These later cases have not yet been heard on appeal, so the full impact of the *Pullman* decision will not be felt for years to come. The *Pullman* case will apply to situations where the proprietary lease clearly allows for terminations based on "objectionable conduct" and the cooperative has judiciously followed the terms of the bylaws in the termination: a shareholder vote is required, all shareholders must receive a notice of the meeting, and the cooperative must be acting in good faith.

The *Pullman* ruling has made it clear in what situations a shareholder can be terminated for objectionable conduct. Perhaps this decision will help avoid expensive and lengthy litigation in the future. **H**