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Giving **Co-op** and **Condo Boards** the Right To **Grandfather** Existing **Privileges**

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Cooperative and condominium boards frequently wish to modify longstanding governance policies to accommodate shifting needs, trends, and demographics within their communities.

However, they are confronted with the dilemma of how to deal with longstanding residents who have been granted allowances in accordance with existing board policies (e.g., permission to harbor pets, sublet their apartments, maintain washing and drying machines within their apartments, or even install hot tubs) and have adjusted their life styles in reliance upon these licenses such that their modus vivendi would be uprooted by an abrupt change in regimen.

One popular solution to this dilemma has been to "grandfather" existing accommodations so that those who have received licenses are permitted to retain their privileges until they naturally expire (i.e. their pet passes, their sublet term comes to an end, or their appliance cannot be repaired), while the new policy applies immediately to those who have not been granted prior approval.

However straightforward this solution may seem, it would likely be in violation of Business Corporation Law (BCL) Section 501(c), which mandates that "each share (of corporate stock) shall be equal to every other share of the same class." Inasmuch as there is typically only one class of stock in a residential cooperative apartment corporation, this provision has been consistently construed to mean that no tenant-shareholder may receive preferential treatment relative to other tenant-shareholders in the administration of corporate policy. A two-tiered policy which permits accommodation through "grandfathering" to some shareholders, but not to others, is clearly preferential in nature. This article suggests a solution to the dilemma, which would permit the expedient of "grandfathering" to facilitate desirable governance changes within residential communities, while still preserving the fundamental BCL mandate of parity among

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corporate stockholders of the same class. The solution described here should apply to both cooperatives and condominium associations even though the BCL does not apply to condominium associations, because courts routinely apply concepts embodied in the BCL to condominiums by analogy.

Shareholder Equality, With One Exception

Courts have treated the principle of shareholder equality as embodied in BCL Section 501 (c) as being virtually sacrosanct. The seminal case construing this statute insofar as it applies to cooperatives is *Fe Bland v. Two Trees Management,* 66 N.Y.2d 556, 498 N.Y.S.2d 336 (1985). Here the Court of Appeals reviewed the validity of transfer fees (popularly known as "flip taxes") enacted by two different cooperatives. One of the co-ops in the *Fe Bland* case enacted a transfer fee which required the seller to pay between $50 and $200 per share depending upon whether he was an original purchaser from the sponsor or an outsider and whether he had been an owner for five years or more or a more recent purchaser. This fee, on its face, treated shareholders of the same class differently. In the other instance, the transfer fee payable by the seller was fixed at 2 percent of the gross sales price. This fee was therefore disparate among shareholders as applied because each seller receives a different price for his stock and thus is forced to pay different transfer fees. The Court of Appeals struck both transfer fees with the pronouncement that "equality is required between shares of the same class." 66 N.Y.2d at 567.

In response to a vigorous lobbying effort by the Co-op Bar, BCL Section 501 (c) was amended to create an exception to the equality mandate for validly enacted co-op transfer fees. This is the sole exception to the rule of parity among shareholders of the same class. See BCL Section 501 (c) (3).

Extending The Reach of 501(c)

The First Department has applied BCL Section 501(c) to strike provisions contained in cooperatives' governing documents which confer preferential rights on original purchasers from the sponsor as opposed to subsequent purchasers with respect to subletting, moving in/out, and closing fees and procedures. *See Wapnick v. Seven Park Ave. Corp.*, 240 A.D.2d 245, 658 N.Y.S.2d 604 (1st Dept. 1997); *Spiegel v. 1065 Park Ave. Corp.,* 305 A.D.2d 204, 759 N.Y.S.2d 461 (1st Dept. 2003). *See also Krakauer v. Stuyvesant Owners*, 301 A.D.2d 450, 753 N.Y.S.2d 367 (1st Dept. 2003*); Lenox Hill Hosp. v. 305/72 Owners,* 90 A.D.3d 470, 933 N.Y.S.2d 866 (1st Dept. 2011).

> The grandfathering principle can easily be equitably and transparently applied and so should be codified into law.

In *Bregman v. 111 Tenants Corp.*, 97 A.D. 3d 75, 943 N.Y.S. 2d 100 (1st Dept. 2012), the First Department extended the reach of BCL Section 501 (c)'s mandate of shareholder parity beyond preferential cooperative governing documents, holding that a discriminatory inducement issued by a conversion sponsor to a subscribing purchaser, which granted her more favorable subletting rights than the standard form proprietary lease conferred on all tenant shareholders, was preferential and therefore void. *Accord*, *DeSoignes v. Cornasesk House Tenants' Corp.*, 21 A.D.3d 715, 800 N.Y.S.2d 679 (1st Dept. 2005); *Jones v. Fordham Hill Owners Corp.*, 225 A.D. 2d 465, 639 N.Y.S.2d 384 (1st Dept. 1996). The First Department proclaimed:

> "We view the directive of BCL 501 (c) as not limited to unequal treatment in proprietary leases or by-laws. It precludes the proposition…that a shareholder purchasing common shares may, by contract with the Cooperative, obtain special rights that could not be granted in the corporate documents themselves."

97 A.D.3d at 83.

The First Department has further extended the mandate of BCL Section 501 (c) to board conduct, striking *corporate action* which results in disparate treatment to shareholders. Thus, in *Pilipovic v. Laight Coop. Corp*., allegations by a tenant shareholder that the board's denial of an alteration request resulted in his apartment being the only one in the building to have only one safe mode of egress was deemed to state a cause of action for violation of BCL Section 501 (c). 137 A.D.3d 710, 29 N.Y.S.3d 280 (1st Dept. 2016). *Accord White v. Gilbert*, 2012 N.Y. Misc. LEXIS 3736; 2012 NY Slip Op 32042 (U) (Sup. Ct. N.Y. Cty., 2012). (However, the First Department's holding in *Moltisanti v. East Riv. Hous. Corp*., 149 A.D.3d 530, 52 N.Y.S.3d 333 (1st Dept. 2017) appears to be contrary.)

Courts have solidly reaffirmed the sanctity of BCL 501(c)'s directive that shareholders of the same class be treated uniformly, even elevating the precept to the level of "public policy." See, *Spiegal v. 1065 Park Ave., supra*, 759 N.Y.S. 2d at 463. Indeed, the only occasions in which courts have refused to apply this doctrine are when the evidence presented in a particular case does not support allegations of disparate treatment (*23 E. 10 LLC v. Albert Apt. Corp*., 2010 N.Y. Misc. LEXIS 5151, 2010 NY Slip Op. 32970 (U) (Sup. Ct. N.Y. Cty. 2010); *Razzano v. Woodstock Owners Corp*. 2012 N.Y. Misc. LEXIS 4942, 2012 NY Slip Op 32628 (U) (Sup. Ct. N.Y. Cty. 2012)) or when the aggrieved shareholder and the shareholder who is alleged to be receiving preferential treatment are deemed to hold different classes of stock in the subject corporation (*Tiemann Place Realty v. 55 Tiemann Owners Corp*, 141 A.D.3d 56, 33 N.Y.S.3d 174 (1st Dept. 2016)). In *Tiemann* the First Department held that cooperative offering plans which accord "holders of unsold shares" preferential rights and privileges over resident shareholders do not violate BCL Section 501 (c) because such holders "effectively constitute a separate class of shareholders." 33 N.Y.S. 3d at 179.

Legislative Intervention

As noted above, co-op boards are often stymied in their desire to effect governance policy changes to address shifting needs and demographics within their building due to the concern of uprooting the established life styles of those shareholders who have acted in reliance upon and have been benefitting from the existing rule, perhaps for decades. While many boards have in fact resorted to grandfathering in these situations, we believe, in light of the courts' uniform application of BCL Section 501 (c), that this practice will be stricken upon its inevitable challenge.

Absent legislative intervention co-op and condo boards will be impeded in their efforts to operate their communities at optimum efficacy. We believe the time has come for the Legislature to consider an amendment to BCL 501 (c) which would carve out an exception to its applicability in situations where cooperative (and condominium) boards amend their governance policies prospectively, but elect to "grandfather" accommodations made to existing shareholders under the policy then in existence. Such an exception would not be unprecedented, as the Legislature has already enacted a similar carve out for "flip taxes" payable to residential cooperative apartment corporations.

As a matter of equity, all co-op and condo owners would theoretically have access to the grandfathering principle, though some would lack access to a given amenity. While I may be precluded from installing a hot tub like Ms. Colombo's today, I may be able to enjoy my vegetable garden in 2028, when the board precludes those who have not been reaping harvests of heirloom tomatoes and romaine lettuce from breaking new ground. The grandfathering principle can easily be equitably and transparently applied and so should be codified into law.

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