Cogan v Lei

2023 NY Slip Op 31699(U)

May 19, 2023

Supreme Court, New York County

Docket Number: Index No. 653221/2022

Judge: Andrew Borrok

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 53

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JOSEPH COGAN, JOSEPH COGAN DERIVATIVELY ON BEHALF OF 38 GRAMERCY PARK INC.,	INDEX NO.	653221/2022
Plaintiff,	MOTION DATE	09/07/2022, 05/09/2023, 05/10/2023
- v -		
JOHN LEI, TZU CHIEN ALAN CHAN, JOHN LAURIA, LANCE EVANS, ALEX LANDES, GRAMERCY 252 OWNER LLC	MOTION SEQ. NO.	001 002 003
Defendant.	**DECISION + ORDER ON MOTION**	

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HON. ANDREW BORROK:

The following e-filed documents, listed by NYSCEF document number (Motion 001) 12, 13, 14, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 49, 73, 75, 76

were read on this motion to/for ARTICLE 78 (BODY OR OFFICER).

The following e-filed documents, listed by NYSCEF document number (Motion 002) 77, 78, 79, 80

were read on this motion to/for PRECLUDE.

The following e-filed documents, listed by NYSCEF document number (Motion 003) 81, 82, 83, 84, 85

were read on this motion to/for QUASH SUBPOENA, FIX CONDITIONS.

Upon the foregoing documents and following the hearing (5.18.23), the Petition (Mtn. Seq. No. 1) must be granted.

The Petitioner argues that the Petition must be granted for three separate reasons. First, the Petitioner argues that the PSA is void pursuant to Article 78 because the Board acted arbitrarily and capriciously and without substantial evidence in signing the PSA (*In re Application of Harold Reape v. Adduci*, 151 AD2d 290 [1st Dept 1989]). Second, the Petitioner argues that the Board violated its fiduciary duties because, among other things, (w) it failed to obtain proper

information as to whether the price for the air rights was appropriate and instead acted on a consultant's report which by its very terms indicated it was not an appraisal and could not be relied on to establish whether the Co-op was getting appropriate value (the only other information was obtained two years earlier in the height of COVID for financing purposes and without separately valuing the air rights), (x) the Board failed to obtain compensation in the PSA for value other than the air rights which was being given to the developer including the cantilevering over the Co-op and the Gramercy Park address transferred by virtue of such cantilevering, (y) the Board failed to obtain disinterested approval from its shareholders (given that the Board members were conflicted in that the Petitioner and certain other shareholders would be disproportionately negatively affected by the contemplated construction of a cantilever over their units which would have no impact whatsoever on the Board member's units) and instead rushed to sign the PSA days before the annual meeting where the Board had previously told the shareholders the proposed transaction would be discussed at such annual meeting, and (z) because the Board distributed false information[1] on numerous occasions to coerce shareholders into believing that the construction of the cantilevered building was inevitable and then structured the deal in a manner to allocate proceeds to unit owners based on the number of shares they had rather than in taking into account the specific value of each unit (*i.e.*, treating a 5th floor unit like a 1st floor unit for the purpose of the allocation). Third, the Petitioner argues that the Board violated BCL § 909(a) because the PSA and the sale of the air rights was an indivisible first step in a series of transactions designed to liquidate the Co-op and transfer

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[1] Among other things, the evidence adduced at the hearing showed that the Board falsely told the shareholders the transaction was needed to shore up the finances of the building when in fact the annual meeting minutes reflect no such need and otherwise falsely suggested that the cantilevered building would be built even without the sale of the air rights. Indeed, the only financial information discussed at the meeting was that for the prior year, the finances were in good shape.

"substantially all of the assets of the Coop" requiring shareholder consent which was not solicited or obtained. As discussed below, the Petitioner is correct on all three grounds.

1. Article 78 Mandates Voiding the PSA

A review of a determination by a board of a Co-op is properly commenced pursuant to Article 78 of the CPLR (*In re Dicker v Glen Oaks Village Owners, Inc.*, 153 AD3d 1399, 1400-1401 [2d Dept 2017]). To challenge a board's decision, an aggravated shareholder-tenant must make a showing that the board acted (i) outside the scope of its authority, (ii) in a way that did not legitimately further the corporate purpose, or (iii) in bad faith (*40 West 67th St. Corp. v Pullman*, 100 NY2d 147, 155 [2003]). A board's decision is subject to annulment if it is not supported by "substantial evidence" or is arbitrary, capricious, or an abuse of discretion (CPLR 7803[3]-[4]). As discussed on the record (5.18.23), the evidence firmly establishes that the Board failed to conduct adequate due diligence before causing the Co-op to enter into the Development Rights Purchase and Sale Agreement dated June 17, 2022 (the **PSA;** NYSCEF Doc. No. 8). The "consulting report" by its terms is not a valuation and does not purport to be one:

> In accordance with your request, we have performed a limited restricted consultation suggesting low, medium, and high potential asking prices for the above referenced property located in Manhattan, New York. We have visited the exterior of the subject site and its environs. This letter and its Addenda should be read in their entirety. This report has been prepared specifically for you, our client, the addressee of this letter and its sole intended user for internal use. It may not be used or relied upon by anyone other than the client, for any purpose whatsoever, without the express written consent of its author. Moreover, as consideration of prices sometimes includes factors favorable to potential purchasers, strict confidentiality will best guard your negotiation position.
>
> ***This consultation is not an appraisal. It does not indicate market value, and none of the customary approaches to value utilized in appraisals have been fully developed. This fundamentally limits the reliability of any conclusions rendered or inferred.*** This analysis has been performed strictly for consideration of asking prices (and not to render an opinion of value)

(NYSCEF Doc. No. 21, at 1 [emphasis added])[2]. No one could reasonably rely on it under the circumstances. Inasmuch as no other due diligence was performed including obtaining a real appraisal or valuation (or otherwise having the consultant perform a proper valuation which could be relied upon), the Board did not have "substantial evidence" and their decision to enter the PSA was arbitrary and capricious. For completeness, the valuation obtained two years earlier in the height of the pandemic which did not value the air rights and was obtained for different purpose was both stale and could not be relied upon as to the PSA. As such, the Petition must be granted.

2. The Board Breached Their Fiduciary Duties

A cooperative board owes fiduciary duties to its shareholders (*Stowe v 19 East 88th St., Inc.*, 257 AD2d 355, 356 [1st Dept 1999]). An agreement entered into by a board of directors in violation of those fiduciary duties is subject to equitable recission (*In re Agrest*, 279 AD2d 471 [2d Dept 2001]). Where a party breaches a duty owed directly to a shareholder independent of any duty owed to the corporation, the shareholder may bring a direct claim (*Serino v Lipper*, 123 AD3d 34, 39 [1st Dept 2014]). The relevant inquiry is whether the alleged loss caused by the defendant's wrongdoing affected the plaintiff differently than other investors or shareholders (*Cont'l Cas. Co. v PricewaterhouseCoopers, LLP*, 57 AD3d 411, 411 [1st Dept 2008], *affd* 15 NY3d 264 [2010]). In this case, the Petitioner brings both derivative and direct claims. He sues derivatively on behalf of the Co-op because he argues that the Co-op breached its fiduciary duties to the Co-op in not acting in the best interests of the Co-op. He sues directly in that the

[2] Indeed, it appears on its face as though it was back engineered to justify a price of $350 per square foot – approximately the price offered by the purchaser.

proposed cantilever of the building will harm him and certain others disproportionately to others and because when he voiced his opposition (and the opposition of 26% of the shareholders) he was frozen out. As discussed above, the Board unquestionably breached its fiduciary duties in failing to perform adequate due diligence as to whether the proposed price for the air rights was appropriate and in not obtaining analysis as to whether separate consideration was appropriate for the cantilevering and the Grammercy Park address (making the developer's development more valuable) which was also part of the deal. The Board also breached their fiduciary duties in disseminating demonstrably false information to the shareholders to coerce them into going along with the deal because "it was inevitable". Among other things, as discussed, the Board led the shareholders to believe that the cantilevered building was to be constructed with or without the sale of the air rights and that this was the Co-op's last chance to sell the air rights. This was obviously false. The Co-op also suggested that the deal was necessary to shore up the Co-op's finances. Nothing in the record indicates that the approximately $3 million that the Co-op would receive would have any material impact on the Co-op's finances or that the finances were in need of any such cash infusion. The only financial information discussed in the minutes was that the finances were in fine shape for the prior year. Nothing (as one would expect if in fact there was a problem) is reflected in the minutes to indicate any financial difficulties. Third, inasmuch as the contemplated construction of the cantilever would affect the Petitioner and certain other shareholders similarly situated disproportionately in a negative way to that of the Board members (and certain other unit owners) disinterested shareholder approval was necessary prior to entering the transaction. It was not obtained. In fact, after having told the shareholders of the Co-op that they were going to discuss the proposed transaction at the upcoming annual meeting, the Board executed the PSA a mere three days before the annual meeting took place so that it

could be announced as a *fait accompli*. Thus, the Board breached their fiduciary duties and the PSA must be rescinded and the PSA is void[3].

3. The PSA is Void Pursuant to BCL § 909(a)

Pursuant to BCL § 909(a), shareholder approval is required for, among other things, the sale of all or substantially all of the assets of a corporation. Although the PSA itself only involves the Co-op's air rights, the evidence indicates that the developer and the Board always intended to compel a sale of the Co-op and that the PSA was an indivisible part of a two step plan to liquidate the Co-op hatched from inception. The problem was that many shareholders (including the Petitioner's wife) had indicated a lack of willingness to sell over the years. Hence, the multi-step approach to coerce a sale. Step 1 – sell the air rights. This was done to <u>attempt</u> to avoid having to obtain shareholder approval. Indeed, at the annual meeting, and after executing the PSA (i.e., Step 1) a few days earlier, the Board announced that the developer had offered $40 million for the entire building which the Board indicated it turned down as too low (without doing any diligence or otherwise presenting such offer to the unit owners):

> As we noted at the annual shareholder meeting, Legion made an offer of 40 Million to buy 38 GPM (outright building sale) and that the BOD turned down as too low"

(NYSCEF Doc. No. 34).

When Step 1 was completed and the deal presented as a done deal to the shareholders, when the shareholders complained[4], the Board moved to Step 2 – sale of the building which they then

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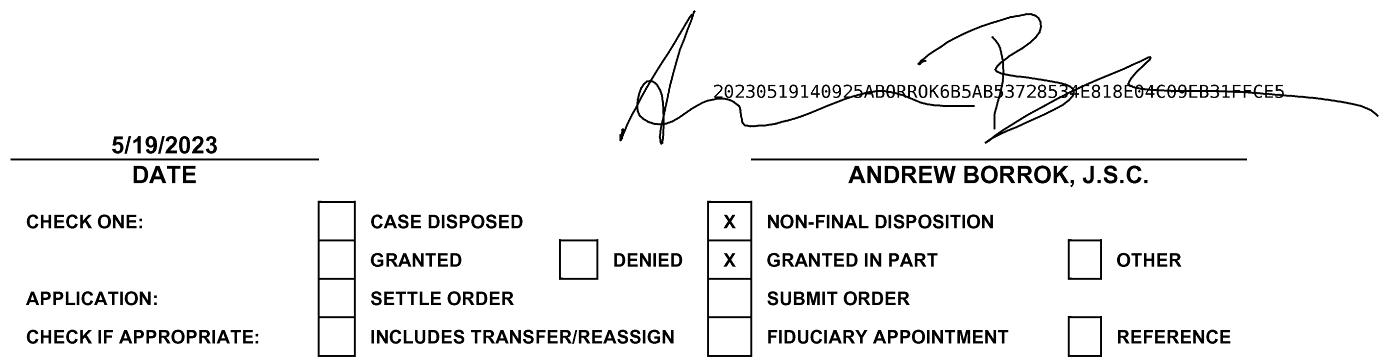
[3] As discussed below, at the annual meeting the Board announced that they had received an offer of $40 million from the developer for the entire building which meant ending the Co-op. This the Board indicated it rejected as being too low and without presenting such offer to the shareholders. This too seems to have been done without basis or proper evaluation.

[4] For completeness, the Court notes that when the Petitioner demonstrated that he had obtained approximately 26% of the proxies and wanted a meeting to get more information as to how was done, the Board ignored him.

presented as a "unique" and "time sensitive opportunity". (*e.g.*, NYSCEF Doc. Nos. 35 and 41). They again disseminated false information to pressure sale both by disparaging the Petitioner's concerns in communications and also by falsely indicating that over 86% of the shareholders favored the transaction (this could not be the case given the Petitioner's proxies). In any event, inasmuch as the PSA was not a one-off transaction and instead was an inseparable part of a contemplated overall sale, shareholder approval was required under BCL § 909(a). Inasmuch as this was not obtained, the PSA is void. For the avoidance of doubt, it does not matter that when the Board realized that the contemplated building sale as cast would trigger adverse tax consequences (*i.e.*, double tax) they had to shuffle and restructure the transaction. What matters is that the sale of the air rights was a step in a transaction with the developer for the sale of substantially all of the assets requiring shareholder consent that was always intended (*Dukas v Davis Aircraft Prod. Co.*, 131 AD2d 720, 721 [2d Dept 1987]; *Kingston v Breslin*, 56 AD3d 430, 431 [2d Dept 2008]).

The Court has considered the respondent's remaining arguments and finds them unavailing. For completeness, the motions in limine (Mtn. Seq. Nos. 002-003) are denied.



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5/19/2023		ANDREW BORROK, J.S.C.
DATE		

CHECK ONE:	☐	CASE DISPOSED		X	NON-FINAL DISPOSITION	
	☐	GRANTED	☐ DENIED	X	GRANTED IN PART	☐ OTHER
APPLICATION:	☐	SETTLE ORDER		☐	SUBMIT ORDER	
CHECK IF APPROPRIATE:	☐	INCLUDES TRANSFER/REASSIGN		☐	FIDUCIARY APPOINTMENT	☐ REFERENCE