



What Recourse Do Buyers Have After Being Rejected By A Co-op Board?

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One of the most unorthodox aspects of buying a co-op in New York City is the idea that a handful of shareholders who comprise of a board of directors have to "approve" a purchaser in order for them to be able to close.

To make matters more interesting, co-op boards do not have to provide any reason for rejection and the process is based on the subjective discretion of the board. Co-op's are governed by New York Business Corporation Law ("BCL").

The BCL provides that a board has a fiduciary duty to act in the best interest of the corporation. This is the standard which co-op boards must abide by in carrying out tasks on behalf of the corporation; such as reviewing a prospective shareholder's financial background and issuing approval.

The issue that often arises is when a board rejects a buyer that has a similar financial situation as one that was previously approved.

In this situation, how can the board make the argument that it is acting in good faith and in the best interest of the corporation, when such inconsistencies exist? Are there set financial guidelines, which the board must adhere to in approving or rejecting a purchaser? Does the buyer have any recourse against the board in this situation?

The answer to the last question is essentially no. A buyer only has recourse against a co-op board if they were discriminated against based several factors, including but not limited to: 1) sexual orientation, 2) gender, 3) age, 4) race, 5) creed or 6) disability. In such instances, the board would have had to make a comment during the board interview or an inquiry perhaps during the application process with respect to one of the aforementioned topics.

The burden of proof in this situation is on the prospective purchaser. This burden is a difficult one to establish as board applications will almost certainly not contain questions relating to the factors listed above and most boards are not foolish enough to make a comment or inquiry of this nature. If the prospective purchaser desired to pursue a claim against the co-op, they would have to file a claim with the City's Human Rights Commission. The Human Rights Commission would hear the case and determine if sufficient evidence has been delivered to establish a discrimination claim.

In the event the prospective purchaser cannot establish a claim based on discrimination, they would have no other recourse against a co-op board. Co-op boards are protected by the "business judgment rule." The business judgment rule enables a co-op board to reject a prospective purchaser for any reason or for no reason, as long as there is no discriminatory reason. The purpose of the business judgment rule is to not infringe on the co-op board's discretionary assessment or expertise in making decisions, unless said decisions were done in bad faith and not in the best interest of the corporation.

This rule essentially does not penalize the board if they made a bad decision on behalf of the corporation and only penalizes them in instances of breach of fiduciary duty or in the case of discrimination. The business judgment rule in most instances prevents judicial review of a board's decisions, so long as the board acts in the best interest of the co-op and in good faith.

There has been a lot of debate on whether co-ops should have guidelines to adhere to and provide reasons for rejection. The major fear is that the reasons for rejection can always be interpreted differently and lead to a whirlwind of litigation, which would be detrimental to all co-op buildings.

It does appear to be an archaic concept that five strangers on the board can in their subjective opinion reject someone from living in a building for no reason. However, until a mechanism can be proposed which wouldn't expose every co-op building to a significant amount of litigation, this is the structure that we will have to continue living with.

In the event that co-op boards ever have to provide a reason for rejection, it could only be tied to a financial reason. Co-ops should have clear-cut financial criteria for prospective purchasers which outline debt to income ratio restrictions, minimum amount of liquidity post-closing, net worth requirements, etc. Several board rejections take place because the board simply was not fond of the candidate and did not think they would be a good fit in their building. This reason is not necessarily discriminatory, however if provided, would lead to a potential discrimination lawsuit. A co-op is run like a corporation and corporations do not have legal requirements for justifying every financial decision they make to their shareholders. However, implementing a requisite financial criteria would provide for some levels of consistency and save buyers a lot of time and money. ■

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