

**Transfer Fees ('Flip Taxes') on the Sale of Cooperative Housing Units Must Be Expressly Permitted by the Tenant-Shareholder's Proprietary Lease or the Cooperative's By-Laws, but May Be Assessed on a Basis that Does Not Treat All Shareholders Alike**

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*Transfer fees ('flip taxes') on the sale of cooperative housing units must be expressly permitted by the tenant-shareholder's proprietary lease or the cooperative's by-laws, but may be assessed on a basis that does not treat all shareholders alike.*

In New York, cooperative housing corporations are organized pursuant to the Business Corporation Law<sup>1</sup> and managed by a board of directors elected by the tenant-shareholders.<sup>2</sup> Courts have frequently upheld various restrictions and fees imposed by such boards on tenant-shareholders as valid exercises of business judgment discretion<sup>3</sup> pursuant to the certificate of incorporation, by-

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<sup>1</sup> While cooperative housing may be organized in several ways, New York cooperatives are almost exclusively formed as corporations. 2 P. ROHAN & M. RESKIN, *REAL ESTATE TRANSACTIONS, COOPERATIVE HOUSING LAW AND PRACTICE* § 2.01[1], at 2-2.1 (1982). Other methods of cooperative formation include the trust form, and various types of co-ownership, including joint tenancy, tenancy in common, and a peculiar California tenancy-in-common cooperative. *Id.* See generally 4B R. POWELL, *POWELL ON REAL PROPERTY* ¶¶ 633.2-633.4 (1985) (creation requirements for cooperative corporation); Note, *Legal Characterization of the Individual's Interest in Cooperative Apartment: Realty or Personalty?*, 73 COLUM. L. REV. 250 (1973) (discussing characteristics of cooperative corporation); Comment, *A Survey of the Legal Aspects of Cooperative Apartment Ownership*, 16 U. MIAMI L. REV. 305 (1961) (review of legal structures available for cooperative organization). Most New York cooperative housing corporations are formed as ordinary business corporations pursuant to the Business Corporation Law. See N.Y. BUS. CORP. LAW §§ 402-403 (McKinney 1963 & Supp. 1986). However, a cooperative housing unit may be organized pursuant to the Cooperative Corporations Law. See N.Y. COOP. CORP. LAW §§ 11, 13-14 (McKinney 1951 & Supp. 1986); P. ROHAN & M. RESKIN, *supra*, § 3.02, at 3-5 (while the Cooperative Corporations Law is "primarily for agriculture cooperatives, housing cooperatives come within its purview"). Corporations formed pursuant to the Cooperative Corporations Law are subject to the provisions of the Business Corporation Law unless expressly displaced by a provision of the Cooperative Corporations Law. See N.Y. COOP. CORP. LAW § 5(1)(a) (McKinney Supp. 1986).

<sup>2</sup> N.Y. BUS. CORP. LAW § 701 (McKinney 1963 & Supp. 1986) ("corporation shall be managed under the direction of its board of directors"). See also *Vernon Manor Coop Apartments v. Salatino*, 15 Misc. 2d 491, 495, 178 N.Y.S.2d 895, 901 (Westchester County Ct. 1958) (board's purpose is to house its members "in a comfortable and efficient manner"); N.Y. BUS. CORP. LAW § 703 (McKinney 1963). Directors are elected at each annual meeting of shareholders, see *id.*, by a plurality of the votes cast at that meeting. See *id.* at § 614.

Pursuant to the business judgment doctrine, boards of directors have imposed numerous restrictions, conditions and fees upon shareholder-tenants that have been upheld by the courts.

<sup>3</sup> See, e.g., *Pardy v. Fountainhead Owners Corp.*, N.Y.L. J., Oct. 2, 1985, at 14, col. 5 (Sup. Ct. Westchester County 1985) (board could refuse sale to woman with small child); *Garrison Apartments, Inc. v. Sabourin*, 113 Misc. 2d 674, 679, 449 N.Y.S.2d 629, 633 (N.Y.C. Civ. Ct. N.Y. County 1982) (security patrol fee held valid exercise of board's business judgment). *Hilltop Village Coop. No. 4 v. Wolman*, 13 Misc. 2d 753, 754, 178 N.Y.S.2d 498, 500 (Sup. Ct. Queens County 1957) (board resolution requiring tenants with washing machines to pay monthly fee not "arbitrary or otherwise illegal"); *Forest Park Coop. v. Hellman*, 2 Misc. 2d 183, 184, 152 N.Y.S.2d 685, 686 (Sup. Ct. Queens County 1956) (board's ban on washing machines in individual apartments held valid act of managerial discretion).

laws and proprietary lease.<sup>4</sup> However, the imposition of a transfer fee commonly known as a "flip tax", payable by the shareholder to the cooperative corporation before a sale, transfer or assignment of the shareholders' corporate interest is approved by the board,<sup>5</sup> has

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Managerial and policy decisions that serve to further legitimate corporate purposes are generally considered to be a valid exercise of board discretion pursuant to the business judgment doctrine, which "bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes." *Auerbach v. Bennett*, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979). By invoking the business judgment doctrine, cooperative boards may legally require shareholders to obtain board consent before selling their ownership interest, unless such refusal is violative of civil rights legislation. *See Weisner v. 791 Park Ave. Corp.*, 6 N.Y.2d 426, 434, 160 N.E.2d 720, 724, 190 N.Y.S.2d 70, 75 (1959) (coop owners entitled to select their co-owners and neighbors, absent decision making based on race, color, religion or nation origin).

Provisions in the by-laws and proprietary leases which afford the cooperative corporation a right of first refusal over share transfers have also been upheld as valid exercises of board discretion. *See, e.g., Penthouse Properties, Inc. v. 1158 Fifth Ave., Inc.*, 256 App. Div. 685, 691-92, 11 N.Y.S.2d 417, 422 (1st Dep't 1939) (coop corporation's right of first refusal not violative of alienation doctrine).

<sup>4</sup> The legal rights and relationships which comprise the cooperative corporation are created by the certificate of incorporation, the corporate by-laws and the proprietary lease. P. ROHAN & M. RESKIN, *supra* note 1, § 2.01[4][b], at 2-8. The certificate of incorporation is filed with the Secretary of State and contains, *inter alia*, the purposes of the corporation. N.Y. BUS. CORP. LAW § 402 (McKinney 1963 & Supp. 1986). The by-laws define and limit the conduct and business of the corporation and "the rights or powers of its shareholders, directors or officers . . ." N.Y. BUS. CORP. LAW § 601(c) (McKinney 1963 & Supp. 1986).

The New York Real Property Law defines a proprietary lease as "a lease to, or held by, a tenant entitled thereto by reason of ownership of stock in a corporate owner of premises which operates the same on a cooperative basis." N.Y. REAL PROP. LAW § 226-b(3) (McKinney Supp. 1986). A proprietary lease embodies the attributes of ownership, affording the tenant-shareholder rights and privileges in a tenancy not normally accruing in a typical landlord-tenant relationship. *See W. EVERETT, THE PURCHASER'S APPROACH TO COOPERATIVE APARTMENTS IN COOPERATIVE APARTMENTS* 29 (2d ed. 1961). Thus, the certificate of incorporation, by-laws and proprietary lease, read together, determine the respective rights and duties of the board and shareholders. *See State Tax Comm'n v. Shor*, 43 N.Y.2d 151, 157, 371 N.E.2d 523, 526, 400 N.Y.S.2d 805, 808 (1977) ("[n]either the stock certificate nor the lease . . . can appropriately be viewed or valued in isolation from the other"); *Vernon Manor Coop Apartments v. Salatino*, 15 Misc. 2d 491, 494, 178 N.Y.S.2d 895, 900 (Westchester County Ct. 1958) (relationship between coop and owner "is embodied in the certificate of incorporation, the by-laws [sic], the rules and regulations, and the member contracts"). *Cf. Brennan v. Breezy Point Coop.*, 63 N.Y.2d 1022, 1025, 473 N.E.2d 738, 740, 484 N.Y.S.2d 510, 512 (1984) (authority of board contained in certificate of incorporation, by-laws, proprietary lease and prospectus).

<sup>5</sup> *See P. ROHAN & M. RESKIN, supra* note 1, § 2.01[5][c][i][A], at 2-12.19. The tenant-shareholders benefit from the imposition of flip taxes since these fees may be used as a source of reserve funds for capital improvements, as a method of keeping monthly maintenance down and as a means of reducing the need for special assessments. *Siegler, Cooperative Housing: Validity of Board-Imposed Resale Fees*, N.Y.L.J., June 13, 1984, at 1, col. 3. The transfer fee may also serve to discourage speculative buying, since tenant-shareholders tend to be more concerned with the condition of the building because of their vested inter-

generated considerable controversy. Courts considering the validity of flip taxes imposed by boards of directors without shareholder approval have reached contrary conclusions.<sup>6</sup> Recently, in *Fe Bland v. Two Trees Management Co.*,<sup>7</sup> the New York Court of Ap-

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est. *See id.* *See also* *Mayerson v. 3701 Tenants Corp.*, 123 Misc. 2d 235, 235, 473 N.Y.S.2d 123, 124 (Sup. Ct. N.Y. County 1984) (flip tax encourages tenant stability); D. CLURMAN, F. JACKSON & E. HEBARD, *CONDOMINIUMS AND COOPERATIVES* 92 (2d ed. 1984) (transfer fee may reduce speculative purchases). Thus, proponents of transfer fees argue that the building will be more attractive to prospective purchasers since maintenance costs and special assessments have been kept to a minimum, while the corporation has been financially able to make necessary capital improvements. *See* *Berglund v. 411 East 57th Corp.*, 122 Misc. 2d 702, 705, 471 N.Y.S.2d 803, 806 (N.Y.C. Civ. Ct. N.Y. County 1984), *rev'd per curiam*, 127 Misc. 2d 58, 488 N.Y.S.2d 947 (Sup. Ct. App. T. 1st Dep't 1985), *aff'd*, 118 App. Div. 2d 431, 499 N.Y.S.2d 715 (1st Dep't 1986).

Transfer fees also discourage speculative purchasers due to tax implications. To qualify for favorable tax treatment, the Internal Revenue Code requires that at least eighty percent (80%) of the cooperative's income be "derived from tenant-stockholders" who reside in the building; an excessive number of non-resident speculative owners could, therefore, jeopardize the tax status of the corporation. *See* I.R.C. § 216(b)(1)(D) (1985). *See also* *Kremnitzer, Allocating Shares in Cooperative Under Internal Revenue Code*, N.Y.L.J., Jan. 9, 1985, at 1, col. 3 (implications of section 216).

Opponents of the transfer fee argue that it places an inequitable confiscatory burden on the seller, since it is imposed only on a special class, namely persons selling their shares. *See* *Siegler, supra*, at 1, cols. 3-4. Further, it is unfair to tenants in a conversion situation who are forced to sell soon after acquisition, since the flip tax may impose financial burdens on the seller. *See id.* The fee also adversely affects the shareholder's investment and equity structure. *See* *330 West End Apartment Corp. v. Kelly*, 124 Misc. 2d 870, 874, 478 N.Y.S.2d 220, 223 (Sup. Ct. N.Y. County 1984), *aff'd*, 108 App. Div. 2d 1107, 486 N.Y.S.2d 586 (1st Dep't 1985), *aff'd sub nom.*, *Fe Bland v. Two Trees Management Co.*, 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (1985).

<sup>6</sup> In a number of cases, resale fees have been declared invalid because the fee was improperly imposed retroactively, or proper shareholder approval was not obtained by the board. *See, e.g.*, *McIntyre v. Royal Summit Owners, Inc.*, 126 Misc. 2d 930, 932, 487 N.Y.S.2d 474, 476 (Sup. Ct. App. T. 1st Dep't 1984) (flip tax approved by shareholders retroactively); *Nantista v. 130 West 86 Apartments Corp.* 130 Misc. 2d 635, 637, 496 N.Y.S.2d 663, 666 (N.Y.C. Civ. Ct. N.Y. County 1985) (fee approved by shareholders after contract for sale entered into by owner); *Jackson v. 239 Central Park West Corp.*, N.Y.L.J., Dec. 27, 1984, at 5, col. 2 (Sup. Ct. N.Y. County 1984) (flip tax not approved by shareholders); *Wallach v. 239 Central West Corp.*, N.Y.L.J., Oct. 4, 1984, at 7, col. 2 (N.Y.C. Civ. Ct. N.Y. County 1984) (flip tax imposed without shareholder approval); Other courts have invalidated flip taxes because of the manner in which the fee was determined. *See, e.g.*, *Frymer v. Bell*, 99 App. Div. 2d 91, 92, 472 N.Y.S.2d 622, 623 (1st Dep't 1984) (fee based on market value held invalid); *Mullins v. 510 East 86th Street Owners, Inc.*, 126 Misc. 2d 758, 759, 483 N.Y.S.2d 631, 633 (N.Y.C. Civ. Ct. N.Y. County 1984) (transfer fee imposed failed to meet proportionality requirements).

Several courts have upheld the validity of flip taxes as a valid exercise of board discretion under the business judgment doctrine. *See* *Mayerson v. 3701 Tenants Corp.*, 123 Misc. 2d 235, 473 N.Y.S.2d 123 (Sup. Ct. N.Y. County 1984); *Tisch v. Park East Property, Inc.*, No. M-2037 (App. Div. 1st Dep't July 31, 1986); *Reifman v. Berkeley Coop. Section III Corp.*, No. 63890/74, slip op. at 2 (N.Y.C. Civ. Ct. N.Y. County Jan. 31, 1975).

<sup>7</sup> 66 N.Y.2d. 556, 489 N.E.2d. 223, 498 N.Y.S.2d. 336 (1985).

peals held that the imposition of a valid transfer fee required shareholder approval, evidenced by a combined reading of all relevant documents—the certificate of incorporation, the by-laws and the proprietary lease—and that any such flip tax must be proportional to share ownership.<sup>8</sup> However, subsequent to this decision, the New York legislature amended the relevant section of the New York Business Corporation Law, thus allowing the imposition of transfer fees that are not proportional to share ownership.<sup>9</sup>

*Fe Bland v. Two Trees Management Co.*

In *Fe Bland*, the Court of Appeals affirmed *Fe Bland v. Two Trees Management Co.*,<sup>10</sup> and modified and affirmed *330 West End Apartment Corp. v. Kelly*,<sup>11</sup> invalidating a flip tax imposed by the board of directors on shareholders at the time of resale in both cases.<sup>12</sup> In *Fe Bland*, the plaintiff, a former shareholder-tenant, sought to recover a \$39,000 flip tax imposed by the defendant co-

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<sup>8</sup> *Id.* at 563, 565, 489 N.E.2d at 225-27, 498 N.Y.S.2d at 340-41.

<sup>9</sup> On July 24, 1986, an amendment to § 501(c) of the New York Business Corporation Law was signed into law by Governor Cuomo. The amendment reads as follows:

(c) Subject to the designations, relative rights, preferences and limitations applicable to separate series, each share shall be equal to every other share of the same class. With respect to corporations owning or leasing residential premises and operating the same on a cooperative basis, however, provided that maintenance charges, general assessments pursuant to a proprietary lease, and voting, liquidation or other distribution rights are substantially equal per share, shares of the same class shall not be considered unequal because of variations in fees or charges payable to the corporation upon sale or transfer of shares and appurtenant proprietary leases that are provided for in proprietary leases, occupancy agreements or offering plans or properly approved amendments to the foregoing instruments.

§ 2. This act shall take effect immediately and shall be deemed to apply to shareholders of cooperative apartment corporations from and after the date of execution of the proprietary leases and occupancy agreements executed before the effective date of this act.

Ch. 598 §§ 1, 2 [1986] N.Y. Laws 1284 (McKinney) (to be codified at N.Y. BUS. CORP. LAW § 501(c)). The amendment appears to have been a legislative reaction to the *Fe Bland* decision. See Siegler, *Business Corporation Law Change Accommodates Co-Op Flip Taxes*, N.Y.L.J., Aug. 1, 1986, at 1, col. 3 (enactment eliminates limitations on permissible flip taxes mandated by *Fe Bland* decision).

<sup>10</sup> 125 Misc. 2d 111, 479 N.Y.S.2d 123 (Sup. Ct. N.Y. County 1984), *aff'd*, 109 App. Div. 2d 1110, 487 N.Y.S.2d 453 (1st Dep't 1985), *aff'd*, 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (1985).

<sup>11</sup> 124 Misc. 2d 870, 478 N.Y.S.2d 220 (Sup. Ct. N.Y. County 1984), *aff'd*, 108 App. Div. 2d 1107, 486 N.Y.S.2d 586 (1st Dep't 1985), *aff'd*, 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (1985).

<sup>12</sup> *Fe Bland*, 66 N.Y.2d at 559-60, 489 N.E.2d at 227, 498 N.Y.S.2d at 338.

operative corporation when the tenant assigned his lease and stock to an outside purchaser.<sup>13</sup> The transfer fee was imposed on the sale retroactively, pursuant to a board resolution passed after the plaintiff had contracted to sell his shares, but prior to the closing.<sup>14</sup> The flip tax was never approved by the shareholders<sup>15</sup> and was a per share resale fee with differing rates depending upon (1) whether the shareholder was an original subscriber or an outside purchaser and (2) the length of time the shareholder owned his stock.<sup>16</sup> However, Fe Bland's proprietary lease provided only for fees related to the actual costs incurred by the cooperative in processing a sale, assignment or transfer.<sup>17</sup> The Supreme Court, Special Term, held that the transfer fee was an unauthorized exercise of the board's power, and that the tax was discriminatory since all shareholders of the same class were not treated equally, as required by section 501(c) of the Business Corporation Law.<sup>18</sup> On appeal, the Appellate Division, First Department, affirmed without opinion.<sup>19</sup>

In *330 West End Apartment Corp. v. Kelly*,<sup>20</sup> the plaintiff cor-

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<sup>13</sup> *Id.* at 560-61, 489 N.E.2d at 227, 498 N.Y.S.2d at 338.

<sup>14</sup> *Id.* Fe Bland was an original subscriber in the building when it was converted in 1980, acquiring 195 shares and the proprietary lease to his apartment for \$112,125. *Id.* at 560, 489 N.E.2d at 225, 498 N.Y.S.2d at 338. Pursuant to a resolution passed by the shareholders at the 1981 annual meeting, the board of directors amended the by-laws on Oct. 6, 1981 to provide for a flip tax of \$2,500 per apartment. *Id.* On October 5, 1983, Fe Bland contracted with a buyer for the assignment of his stock and proprietary lease for \$550,000. *Id.* On November 1, 1983, however, two weeks prior to the closing, the board of directors, without shareholder approval, amended the original flip tax resolution. *Id.*

<sup>15</sup> *Id.* at 560-61, 489 N.E.2d at 225, 498 N.Y.S.2d at 338.

<sup>16</sup> *Id.*, 489 N.E.2d at 225, 498 N.Y.S.2d at 338. The amendment required a shareholder to pay a per share fee in order to obtain board approval for a sale or assignment that varied "from \$50 to \$200 per share depending upon whether the [shareholder-seller] was an original purchaser . . . or an outsider and whether he had been an owner for five years or more." *Id.* (footnote omitted).

<sup>17</sup> *Id.* at 564, 489 N.E.2d at 229, 498 N.Y.S.2d at 341. Fe Bland was forced to pay a \$39,000 transfer fee and sign "a general release in favor of the" defendants. *Id.* at 561, 489 N.E.2d at 221, 498 N.Y.S.2d at 338.

<sup>18</sup> *See Fe Bland*, 125 Misc. 2d at 116, 479 N.Y.S.2d at 127. The trial court held that the board's resolution of November 1, 1983 violated "the proportionality requirements of the certificate of incorporation" and section 501(c) of the and Business Corporation Law. *Id.* at 116, 479 N.Y.S.2d at 127; *see also supra* note 9 (discussion of 501(c)). The trial court also found that the proprietary lease did not authorize a flip tax and that the fee violated the proprietary lease's cash requirements provision. *Fe Bland*, 125 Misc.2d at 115, 479 N.Y.S.2d at 126.

<sup>19</sup> *Fe Bland*, 109 App. Div. 2d 1110, 487 N.Y.S.2d 453 (1st Dep't 1985).

<sup>20</sup> 124 Misc. 2d 870, 478 N.Y.S.2d 220 (Sup. Ct. N.Y. County 1984), *aff'd* 108 App. Div. 2d 1107, 486 N.Y.S.2d 586 (1st Dep't 1985), *aff'd*, 66 N.Y.2d 556, 489 N.E.2d 223, 498

poration sought a declaratory judgment as to the validity of a \$6,300 flip tax charged to the defendant-shareholder when he sold his stock and assigned his proprietary lease to a third party.<sup>21</sup> The flip tax, set at two percent of the gross sales price, was imposed pursuant to a board resolution that was never approved by the shareholders.<sup>22</sup> Special Term held that the fee imposition was within the board's scope of authority under the business judgment doctrine but awarded the defendant summary judgment because the flip tax was not authorized by the shareholders proprietary lease.<sup>23</sup> On appeal the Appellate Division, First Department, affirmed without opinion.<sup>24</sup>

The Court of Appeals addressed several major issues in deciding the two cases. Writing for the court, Judge Meyer stated that the legal relationship between a cooperative housing corporation and its tenant-shareholders is a product of all relevant corporate documents (the by-laws and the certificate of incorporation), the proprietary lease and the applicable statutory and decisional law.<sup>25</sup> After concluding that the relevant provisions of the leases and by-laws in both cases were almost identical,<sup>26</sup> the court held that, when read together, these documents merely permitted each corporation to assess fees directly related to the actual costs incurred by the corporation in transferring the stock and the leases.<sup>27</sup> Thus, the

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N.Y.S.2d 336 (1985).

<sup>21</sup> *Fe Bland*, 66 N.Y.2d at 562, 489 N.E.2d at 226, 498 N.Y.S.2d at 339. The defendant counterclaimed for the return of the fee, contending that the board had no authority to impose a flip tax. *Id.*, 489 N.E.2d at 226, 498 N.Y.2d at 339. Kelly, an original subscriber in 330 West End Apartment Corporation when it was formed in 1980, had purchased 2,700 shares of stock and the proprietary lease for \$270,000. *Id.* He received \$315,000 from the purchaser of his apartment. *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *See Kelly*, 124 Misc. 2d at 873-74, 478 N.Y.S.2d at 223-24; *See also supra* note 3 (discussion of business judgment doctrine). The trial court held that while the board of directors had the necessary authority to impose the fee under the by-laws pursuant to the business judgment doctrine, the fee was not authorized by the proprietary lease because, while the lease required the assignor to pay certain expenses, it did not authorize the imposition of a flip tax; in addition, a three-fourths vote of the shareholders was required for any modification of the lease. *Kelly*, 124 Misc. 2d at 873, 478 N.Y.S.2d at 223.

<sup>24</sup> *Kelly*, 108 App. Div. 2d 1107, 486 N.Y.S.2d 586 (1st Dep't 1985).

<sup>25</sup> *Fe Bland*, 66 N.Y.2d at 563, 489 N.E.2d at 227, 498 N.Y.S.2d at 340.

<sup>26</sup> *Id.* at 563-65, 489 N.E.2d at 227-29, 498 N.Y.S.2d at 340-41.

<sup>27</sup> *Id.* The by-laws in question provided for "reasonable fee[s] to cover actual expenses and attorneys' fees of the [c]orporation, a service fee . . . and *such other conditions* as [the board] may determine, in connection with such proposed assignment." *Id.* at 563-64, 489 N.E.2d at 227, 498 N.Y.S.2d at 340 (emphasis added). The court concluded, contrary to the corporation's contention, that the phrase "such other conditions" did not include monetary

court concluded that the resolutions passed by the boards of directors in *Fe Bland* and *Kelly* had no effect on the proprietary leases at issue, since these leases were part of the agreement between the shareholders and the corporation and therefore required a shareholder-approved amendment to implement a valid transfer fee.<sup>28</sup>

While the business judgment doctrine permits a board wide latitude to impose fees and conditions upon tenant-shareholders in furtherance of legitimate corporate purposes,<sup>29</sup> the court ruled that a flip tax was beyond the board's inherent authority because it was contrary to the express limitations and authority granted to the board by the by-laws and proprietary lease.<sup>30</sup> The court of appeals found that the "cash requirements provision" of each lease required that any fees imposed upon shareholders had to be proportional to the amount of the transferor's stock as compared to the total shares issued and outstanding.<sup>31</sup> Since the transfer fees were not based upon the actual percentage of ownership, the court held that the flip tax was invalid on this ground as well.<sup>32</sup> Lastly, the court concluded that section 501(c) of the Business Corporation Law required any fees or conditions imposed upon shareholders to be on a per share basis.<sup>33</sup> Since the transfer fee in *Fe Bland* was not based solely upon the plaintiff's share ownership, the court held that the board resolution violated the rule of equal treatment for all shareholders owning the same class of stock.<sup>34</sup>

assessments. *Id.* at 564, 489 N.E.2d at 227-28, 498 N.Y.S.2d at 340-41. The proprietary lease authorized the collection of "reasonable legal and other expenses . . . in connection with such assignment and transfer of shares," and limited the board's discretion to those fees and conditions "specifically provided" for in the lease. *Id.* at 564, 489 N.E.2d at 227, 498 N.Y.S.2d at 341.

<sup>28</sup> *Id.* at 563-66, 489 N.E.2d at 227-29, 498 N.Y.S.2d at 340-41.

<sup>29</sup> *Id.* at 565, 489 N.E.2d at 228, 498 N.Y.S.2d at 341; *see supra* note 4.

<sup>30</sup> *Fe Bland*, 66 N.Y. 2d at 565, 489 N.E.2d at 228, 498 N.Y.S.2d at 341.

<sup>31</sup> *Id.* at 565-66, 489 N.E.2d at 228, 498 N.Y.S.2d at 341-42.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 566-69, 489 N.E.2d at 229-31, 498 N.Y.S.2d at 342-44. Cooperative corporations normally have only one class of stock. This is required by the Internal Revenue Code section 216 as a prerequisite for tenant-stockholders to personally deduct their proportionate share of the cooperative's expense deductions. *Id.* at 567, 489 N.E.2d at 229, 498 N.Y.S.2d at 342-43; I.R.C. § 216(b)(1)(A) (1985). *See also* Kremnitzer, *supra* note 5, at 1, col. 3 (section 216 permits deduction by tenant-stockholder of interest and taxes).

<sup>34</sup> *Fe Bland*, 66 N.Y.2d at 566-69, 489 N.E.2d at 229-31, 498 N.Y.S.2d at 342-44. The court found it unnecessary to decide whether the \$2,500 flip tax passed by the shareholders in *Fe Bland* was valid, since it was not in issue. *Id.* at 566-67, 489 N.E.2d at 229, 498 N.Y.S.2d at 342. However, the Court stated that such fee was invalid because it was on a per apartment basis, and was, therefore, violative of section 501(c) of the Business Corporation Law.



The *Fe Bland* decision mandates that any transfer fees not reasonably related to the expenses incurred by the cooperative in transferring the shares to a purchaser must be provided for by a combined reading of the certificate of incorporation, the by-laws and the proprietary lease.<sup>35</sup> Generally, these documents are standardized and permit only proportional fees and assessments, as did the provisions in *Fe Bland*.<sup>36</sup> It is submitted that express shareholder approval would be required to amend both the by-laws and proprietary lease in order to enact a legally enforceable flip tax because such a fee constitutes a material alteration in the relationship between the shareholder and the corporation.<sup>37</sup> Moreover, the fiduciary duty owed by the board of directors to the tenant-shareholder<sup>38</sup> necessitates shareholder approval of a flip tax since such a fee does not bear a reasonable relationship to the express authority of the board to enact measures which benefit all of the share-

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Additionally, the *Fe Bland* court stated that the proprietary lease had a stricture against retroactive assessments, and invalidated the flip tax on that ground as well. *Id.* at 566, 489 N.E.2d at 228, 498 N.Y.S.2d at 342. Even without such a clause in the lease, a retroactive flip tax could not be legally imposed. *See, e.g., McIntyre v. Royal Summit Owners, Inc.*, 126 Misc. 2d 930, 933, 487 N.Y.S.2d 474, 476 (Sup. Ct. App. T. 1st Dep't 1984) ("essence of the transaction" between buyer and seller was completed before retroactive flip tax was enacted by board). Thus, subsequent shareholder approval will not constitute a valid ratification of any amendments passed by the board and cannot relate back. *See RESTATEMENT (SECOND) OF AGENCY* §§ 82, 89 & comment b (1957) (material change of circumstances makes ratification voidable); H. REUSCHLEIN, *HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP* § 34, at 77 (1979) (changed circumstances will "preclude ratification").

<sup>35</sup> *Fe Bland*, 66 N.Y.2d at 563, 489 N.E.2d at 227, 498 N.Y.S.2d at 340. Shareholder approval would, therefore, normally be required to amend the lease and by-laws (unless provisions were made at the time of conversion in all the relevant documents). *See id.*

<sup>36</sup> *See Clurman, Letters to the Editor*, N.Y.L.J., June 18, 1984, at 2, col. 6 (almost all proprietary leases have standardized provisions).

<sup>37</sup> *See 330 West End Apartment Corp. v. Kelly*, 124 Misc. 2d 870, 873, 478 N.Y.S.2d 220, 223 (Sup. Ct. N.Y. County 1984), *aff'd*, 108 App. Div. 2d 1107, 486 N.Y.S.2d 536 (1st Dep't 1985), *modified and aff'd sub nom. Fe Bland v. Two Trees Management Co.*, 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (1985) (board cannot "amend a material contractual provision of the proprietary lease" without the required shareholder approval); *Fe Bland v. Two Trees Management Co.*, 125 Misc. 2d 111, 116-17, 479 N.Y.S.2d 123, 127 (Sup. Ct. N.Y. County 1984), *aff'd*, 109 App. Div. 2d 1110, 487 N.Y.S.2d 453 (1st Dep't 1985), *aff'd* 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (1985) (flip tax represents "material changes in the terms of the proprietary lease which the board lacks authority to accomplish"); *see also supra* note 4 (discussing legal relationships created by coop documents).

<sup>38</sup> *See Schwartz v. Marien*, 37 N.Y.2d 487, 494, 335 N.E.2d 334, 338, 373 N.Y.S.2d 122, 126-27 (1975) (board owes fiduciary duty to treat all shareholders equally and not "use their position for their own personal advantage or for that of their confederates or to the detriment of stockholders"); *Fe Bland v. Two Trees Management Co.*, 125 Misc. 2d at 116, 479 N.Y.S.2d at 127 (board of directors has duty to treat all shareholders evenhandedly).

holders.<sup>39</sup>

#### RECENT AMENDMENT TO SECTION 501(c).

*Fe Bland* held, *inter alia*, that pursuant to section 501(c) of the Business Corporation Law, all shareholders of the same class of stock must be treated alike.<sup>40</sup> While the decision stirred controversy concerning the mechanics of a valid flip tax,<sup>41</sup> many questions have been resolved by a recent amendment to section 501(c).<sup>42</sup> The amendment expressly provides that cooperative housing corporations may impose fees upon the "sale or transfer of shares and appurtenant proprietary leases. . ." which are not proportional to share ownership. The amended statute now provides that flip taxes must be provided for in the relevant corporate documents.<sup>43</sup> Further, the amended version of section 501(c) has retroactive effect, thus validating flip taxes imposed prior to the date the amendment was passed.<sup>44</sup>

It is submitted that the flip tax in *Fe Bland*, would still be invalid under the new amendment since the flip taxes at issue violated the agreement between the cooperatives and shareholders.<sup>45</sup>

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<sup>39</sup> See *Fe Bland*, 66 N.Y.2d at 563-65, 489 N.E.2d at 227-29, 498 N.Y.S.2d at 340-42 (fee beyond inherent authority of board's business judgment); *supra* note 3 (restrictions which bear reasonable relationship to purpose for which corporation was formed); *supra* note 4 (authority of board determined by by-laws, lease and certificate of incorporation).

<sup>40</sup> *Fe Bland*, 66 N.Y.2d at 567-69, 489 N.E.2d at 229-31, 498 N.Y.S.2d at 342-41.

<sup>41</sup> See Sadowsky, *Court Clarifies the Law Regarding Co-op Flip Tax*, N.Y.L.J., March 12, 1986, at 23, col. 1; Margolies & Weisberg, *Flip Tax Decision Raises Complex Issues for Co-ops*, N.Y.L.J., March 12, 1986 at 29, col. 1; Brooks, *Talking Flip Taxes—Decision Raises Questions*, N.Y. Times, Feb. 2, 1986, § 8 (Real Estate), at 1, col. 1.

<sup>42</sup> See *supra* note 9 for the text of this amendment. Flip taxes have been based on a variety of factors, including: a flat fee per apartment based upon the size of the apartment; a flat fee per share; a flat percentage of the gross selling price of the cooperative unit; and a percentage of profits derived from the sale. See *Fe Bland*, 125 Misc. 2d at 113 n.2, 479 N.Y.S.2d at 125 n.2; Siegler, *Cooperative Housing: Validity of Board-Imposed Resale Fees*, N.Y.L.J., June 13, 1984, at 1, col. 3. It is suggested that under the new amendment to section 501(c) all of these formulas would be valid.

<sup>43</sup> N.Y. Bus. Corp. Law § 501(c) (McKinney Aug. 1986).

<sup>44</sup> *Id.*; see *supra* note 9 for the text of this provision.

<sup>45</sup> See, e.g., Siegler, *Business Corporation Law Change Accommodates Co-Op Flip Taxes*, N.Y.L.J., Aug. 1, 1986, at 1, col. 3, at 2, col. 6 (*Fe Bland* holding that requires shareholder approval for valid flip tax not affected by new amendment); Brooks, *Questions Raised on Co-Op Law*, N.Y. Times, Aug. 3, 1986, § 8 (Real Estate), at 1, col. 1, at 12, cols. 1-2 (effective flip tax must still be authorized in relevant documents).

Furthermore, the recent amendment to section 501(c) does not contravene, and perhaps implicitly codifies, the *Fe Bland* mandate that a combined reading of all the relevant documents must permit the imposition of a flip tax. Thus, shareholder approval of any flip tax will still be required, and although the statute has retroactive application, a transfer fee imposed without shareholder approval prior to the date of the new legislation would be an invalid exercise of corporate power.

*Alexander Sokoloff*

### CIVIL PRACTICE LAW AND RULES

*CPLR 203(e): Plaintiff may assert an otherwise time-barred claim against a third-party defendant if court in its discretion finds defendant had notice of the claim and amended complaint relates back to service of third-party complaint.*

CPLR 203(e) allows a plaintiff, in amending a timely complaint, to include an otherwise time-barred claim, provided the original pleading has given sufficient notice of the transactions or occurrences "to be proved pursuant to the amended pleading."<sup>1</sup> CPLR 203(e) was enacted to overcome case law which prohibited

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<sup>1</sup> See CPLR 203(e) (McKinney 1972). CPLR 203(e) provides:

A claim asserted in an amended pleading is deemed to have been interposed at the time the claims in the original pleading were interposed, unless the original pleading does not give notice of the transactions, occurrences, or series of transactions or occurrences, to be proved pursuant to the amended pleading.

*Id.* Section 203(e) was based on Rule 15(c) of the Federal Rules of Civil Procedure which provides that an amendment may relate back only if the claim against the new party arose out of the "conduct, transaction, or occurrence" set forth in the original pleading and if the party sought to be added knew or should have known of the institution of the suit. See 1 WK&M ¶ 203.29, at 2-118.16 (1986); *The Quarterly Survey*, 41 ST. JOHN'S L. REV. 283, 284 (1966); *The Quarterly Survey*, 41 ST. JOHN'S L. REV. 467, 467 (1967); see also M. GREEN, BASIC CIVIL PROCEDURE 135 (2d ed. 1979) (relation back theory underlying Rule 15(c)).

The practical effect of CPLR 203(e) was to necessitate that a defendant make a comprehensive, timely examination of all facts surrounding the transaction to anticipate potential claims which could be added later. See, e.g., *Henegar v. Freudenheim*, 40 App. Div. 2d 825, 826, 337 N.Y.S.2d 280, 282 (2d Dep't 1972) (amendment to assert lack of informed consent permitted in medical malpractice action); *Watso v. City of New York*, 39 App. Div. 2d 960, 961, 333 N.Y.S.2d 492, 493 (2d Dep't 1972) (amendment of wrongful death complaint to allege assault as well as negligence); see also, *The Biannual Survey*, 39 ST. JOHN'S L. REV. 178, 184-85 (1964).