511 West 232nd Owners Corp. v. Jennifer Realty Co.: An Insight into the Duties of Cooperative Conversion Sponsors in New York

Kristina Wesch
COMMENT

511 WEST 232ND OWNERS CORP. V. JENNIFER REALTY CO.: AN INSIGHT INTO THE DUTIES OF COOPERATIVE CONVERSION SPONSORS IN NEW YORK

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INTRODUCTION

According to Judge Cardozo, "[t]he law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal."¹ Thus follows a prevailing principle of contract interpretation: a court may supply a contract term where an agreement between parties fails to resolve the dispute that has arisen.² The New York Appellate Division, First Department, in 511 West 232nd Owners Corp. v. Jennifer Realty Co.,³ drew on this rubric and made an unprecedented decision, holding that the sponsor of a cooperative conversion has a duty to market those shares which remain unsold at the time of conversion within a reasonable amount of time.⁴ On appeal, the New York Court of Appeals affirmed the

¹ J.D. Candidate, June 2003, St. John's University School of Law; B.A., 1996, Queens College.
² Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 91, 118 N.E. 214, 214 (1917) (finding a promise to use "reasonable efforts" to be fairly implied in a contract when unexpressed).
³ See E. ALLAN FARNSWORTH, CONTRACTS § 7.16 (3d ed. 1998) (discussing the process of supplying terms).
⁴ Id. at 245, 729 N.Y.S.2d at 34–35.
decision of the appellate division and left it for the lower court to
decide whether the sponsor's ten-year delay was reasonable.\(^5\)

In 1998 the cooperative corporation of 511 West 232nd, the
plaintiff in the action, became aware that Jennifer Realty, the
sponsor of the co-op, had turned down a purchase offer on a
vacant apartment.\(^6\) Subsequently, the plaintiff brought an
action against Jennifer Realty and the members of the co-op's
board of directors to compel them to sell the unsold shares they
held since the July 15, 1988 closing.\(^7\) These unsold shares
comprised more than sixty-two percent of the corporate stock,
giving the sponsor de facto control over the cooperative
corporation.\(^8\)

The plaintiff alleged that the offering plan and material
omissions led them to believe that Jennifer Realty would sell the
shares "at the earliest opportunity, but in no event later than
when each unit became vacant."\(^9\) Instead of selling, the sponsor
kept all of its shares in order to rent vacant units to transient
tenants at a profit greater than what it would have reaped by

\(^5\) The appellate division certified the following question: "Was the order of this
Court, which modified the order of the Supreme Court, properly made?" 511 West
232nd Owners Corp. v. Jennifer Realty Co., 98 N.Y.2d 144, 151, 773 N.E.2d 496,
499, 746 N.Y.S.2d 131, 134 (2002). In an opinion by Judge Rosenblatt, the New York
Court of Appeals, passing only upon the sufficiency of the contract cause of action
and not the merits of the case, answered the certified question in the affirmative,
stating "that plaintiffs have pleaded a cause of action for breach of contract
sufficient to survive dismissal under CPLR 3211." Id. at 151, 773 N.E.2d at 499, 746
N.Y.S.2d at 134.

\(^6\) Jennifer Realty, 285 A.D.2d at 246, 729 N.Y.S.2d at 35.

\(^7\) Id. at 245, 729 N.Y.S.2d at 34-35. Defendant had not sold any shares since

\(^8\) Jennifer Realty, 285 A.D.2d at 245, 729 N.Y.S.2d at 35. In the cooperative
form of real estate ownership, the "owner" of the apartment does not own the unit
he lives, but rather owns stock in that building. This stock entitles him to a long-
term proprietary lease of a unit within the building and gives him voting power in
this entity, which is termed a cooperative corporation. Thus, with regard to
occupancy, each stockholder is in the position of a tenant, with the corporation
acting as landlord. See Richard J. Kane, The Financing of Cooperatives and
Condominiums: A Retrospective, 73 ST. JOHN'S L. REV. 101, 115 (1999); see also
Vincent Di Lorenzo, Disclosure as Consumer Protection: Unit Purchasers' Need for
Additional Protections, 73 ST. JOHN'S L. REV. 43, 48 (1999) ("In form, cooperative
offerings are offerings of stock... although in substance they are offerings of
ownership of real estate."). For a discussion of the distinctions between cooperative
and condominium ownership, see Joel E. Miller, Condominiums and Cooperatives:
The General Utilities Repeal and Co-op to Condo Conversions, 16 J. REAL EST.

\(^9\) Jennifer Realty, 285 A.D.2d at 246, 729 N.Y.S.2d at 35.
selling the shares.\textsuperscript{10} Plaintiff additionally alleged that by holding onto these unsold shares, the board members breached the fiduciary duties they owed to the cooperative corporation.\textsuperscript{11}

The Supreme Court, Bronx County, granted the defendants' motion to dismiss the breach of contract complaint, and held that "the parties' obligations to each other were contained exclusively in the plan and subscription agreement, and that the plan did not reveal any promise by the sponsor to sell the shares within any particular time frame."\textsuperscript{12}

The Appellate Division, First Department reinstated the breach of contract action, finding that although there was neither an express term in the offering plan nor a state statutory obligation that the sponsor shall sell unsold shares after an offering plan has become effective, such an obligation does indeed exist.\textsuperscript{13} The court viewed the offering plan as a contract between the sponsor and the unit purchasers.\textsuperscript{14} Approaching the interpretation of the offering plan from a contractual basis, the court employed the traditional principle of contract law that

\textsuperscript{10} Jennifer Realty, 98 N.Y.2d at 152, 773 N.E.2d at 499–500, 746 N.Y.S.2d at 134–35 ("The complaint narrates that the sponsor had represented that its expected profits would depend on market conditions and the length of time required to sell shares offered under the offering plan, but gave no hint that it would make a sizeable profit by retaining a majority of those shares and leasing apartments at market rates, free of the strictures of rent regulation.").

\textsuperscript{11} Jennifer Realty, 285 A.D.2d at 246, 729 N.Y.S.2d at 35.

\textsuperscript{12} Id. at 246, 729 N.Y.S.2d at 35. Justice Jerry Crispino, sitting in the trial court, "denied defendants' motion to dismiss plaintiff's fraud, breach of fiduciary duty, permanent injunction and General Business Law §§ 349 and 350 fraud claims." Id. at 248, 729 N.Y.S.2d at 36–37. The appellate division modified the order of the supreme court by dismissing the plaintiff's common law and General Business Law fraud claims. Id. at 248, 729 N.Y.S.2d at 36. Under the Martin Act, the plaintiff did not have standing to raise the claims because only the attorney general can take action against fraudulent securities practices that violate the Act, and "[w]hile private plaintiffs may maintain common-law fraud claims, plaintiffs are not permitted to disguise claims which rightfully belong to the Attorney General as their own." Id. at 248, 729 N.Y.S.2d at 36.

\textsuperscript{13} See id. at 246–47, 29 N.Y.S.2d at 35–36. In New York City, conversions to cooperative and condominium ownership are controlled by General Business Law section 352-eeee. Section 352-eeee(2)(d)(ix) states that a sponsor must offer the tenants-in-occupancy the exclusive right to purchase the apartments or the shares appurtenant thereto during the initial ninety days after the date that an eviction plan was accepted for filing. The statute is otherwise silent as to any duty to sell unsold shares once the offering plan has been effectuated. N.Y. GEN. BUS. LAW § 352-eeee(2)(d)(ix) (McKinney 1996 & Supp. 2002).

"[i]mplied promises are recognized when... necessary to effectuate the purpose of the contract." Because the purpose of the offering plan was for the sponsor to sell cooperative apartments within the building, the court found and implied promise that the unsold shares would be sold within a reasonable amount of time was necessarily part of the offering plan. Furthermore, from the vantage point of the plaintiff, it was generally understood at the time of contract formation that the sponsor would diligently market and dispose of his units as soon as circumstances permitted, allowing plaintiff to realize the benefits of being cooperative owners. All parties recognized the attainment of these benefits as the primary objective of the transaction.

Thus, the basis of the appellate division's holding was that the plan, viewed as a contract, contained both express and implied promises. In using this theory to hold that the sponsor

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15 Jennifer Realty, 285 A.D.2d at 247, 729 N.Y.S.2d at 36. In making this determination, the court relied on Grossman v. Schenker, 206 N.Y. 466, 468–69, 100 N.E.2d 39, 40 (1912), which asserted that what is implied in a contract is as much a part of the contract as what is expressed, and Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 90–91, 118 N.E. 214, 214 (1917), which stated that promises can be fairly implied in a contract.

16 See Jennifer Realty, 285 A.D.2d at 247, 729 N.Y.S.2d at 36.

17 See id. at 247, 729 N.Y.S.2d at 36. The court noted that the plaintiff did not realize any of the benefits of cooperative ownership that induced it to engage in the transaction in the first place. "[T]hey are unable to sell or refinance their purchased units, [they] must subsidize repairs for Jennifer Realty’s rental units, and are forced to live in a building populated by transient tenants." Id. at 247, 729 N.Y.S.2d at 36.

18 See id. at 247, 729 N.Y.S.2d at 36. It has been recognized that one of the primary benefits of cooperative ownership is the shareholders' ability to create a stable environment of owners of their own choosing. See Kane, supra note 8, at 103; Michael A. Riccardi, 'Reasonable Time' Restricts Sponsor on Selling Co-ops, N.Y. L.J., Aug. 10, 2001, at 1. Another primary benefit is a voice in self-management. See Di Lorenzo, supra note 8, at 56.

Legislative history also supports this interpretation of the policy behind cooperative conversions. In enacting General Business Law section 352-eeee, the legislature declared that "cooperative... ownership is an effective method of preserving, stabilizing and improving neighborhoods and the supply of sound housing accommodations." N.Y. GEN. BUS. LAW § 352-eeee note (Mckinney 1996) (Legislative findings of L.1982, c. 555, §1). From this it can be surmised that Jennifer Realty's "10-year failure to sell more than 60 percent of the shares... may have defeated the intent of the plan, since the building is populated mainly by transient tenants and not owners." Riccardi, supra at 18. For more on the benefits of cooperative ownership, see Scott E. Mollen, Alternate Dispute Resolution of Condominium and Cooperative Conflicts, 73 ST. JOHN'S L. REV. 75, 78–79 (1999).

19 See Jennifer Realty, 285 A.D.2d at 247, 729 N.Y.S.2d at 35–36; see also Grossman, 206 N.Y. at 469, 100 N.E. at 40 ("A contract includes, not only what the
of a cooperative conversion has a duty to sell unsold shares within a reasonable amount of time, the First Department injected an unprecedented new standard into cooperative conversion law. The court, however, completely failed to lay out the parameters of its holding; it provided no guidelines regarding the scope of the holding, and it did not explain how courts were to apply the holding in future cases. Furthermore, the opinion declined to even acknowledge several serious ramifications that would result from enforcement of this implied duty.\(^{20}\)

Upon appeal, the New York Court of Appeals affirmed the order of the appellate division.\(^{21}\) It is arguable, however, whether the Court of Appeals merely affirmed the appellate division’s decision to reinstate the contract cause of action, or whether the Court of Appeals affirmed the appellate division’s findings on the merits with regard to the breach of contract claim.\(^{22}\) The confusion on this point originates from the fact that after an analysis of the implicit duties arising in contract dealings, the Court of Appeals made the following statement:

\(^{20}\) See Scott E. Mollen, Realty Law Digest, N.Y. L.J., Sept. 12, 2001, at 5 [hereinafter Mollen, Sept. 12, 2001] (commenting that “the subject decision does not attempt to define ‘a reasonable time’ . . . ”).


\(^{22}\) The majority of opinions voiced thus far seem to agree that the Court of Appeals clearly did not pass upon the merits of the breach of contract cause of action. See Kenneth R. Jacobs, Right of Co-op Corporations Compel Sponsors to Sell Apartments, 16 N.Y. REAL EST. L. REP. 1 (2002) (arguing that the court’s analysis was restricted to the sufficiency of the cause of action under the facts pleaded); Adrienne B. Koch, Does a Sponsor Have a Duty to Sell Co-Op Shares?, N.Y. L.J., July 22, 2002, at 4, 6 (interpreting the Court of Appeals’ decision as an acknowledgement that a co-op could demonstrate that an offering plan led it to infer an implied duty into the contract “to sell shares faster than [the sponsor] ultimately did”); Scott E. Mollen, Realty Law Digest, N.Y. L.J., Aug. 28, 2002, at 6 [hereinafter Mollen, Aug. 28, 2002] (agreeing that the issue is still open for litigation); Jay Romano, Conversions and Their Sponsors, N.Y. TIMES, June 30, 2002, § 11 (Real Estate), at 5 [hereinafter Romano, June 30, 2002] (stating that many believe the court only afforded shareholders an opportunity to prove that such an implied duty exists); Jay Romano, Duty to Sell Apartments by Sponsor, N.Y. TIMES, June 23, 2002, § 11 (Real Estate), at 5 [hereinafter Romano, June 23, 2002] (quoting attorneys who believe the court only said that “it is conceivable that there may be circumstances where a sponsor may have made an implicit promise to sell apartments”). But see id. (citing the argument by the chairman and president of the Council of New York Cooperatives and Condominiums, who both say that the Court of Appeals has “definitively” ruled that a sponsor has a duty to sell apartments within a reasonable amount of time).
We emphasize, however, that we address only the sufficiency of the contract cause of action and not its merits. We note that the Appellate Division went so far as to hold that the sponsor had undertaken a duty to dispose of the units within a reasonable time. The Court thus decided that issue and left open only the question of whether the sponsor's 10-year delay was reasonable.  

Regardless of this debate, it seems likely that this issue will be the subject of future litigation. Assuming that the Court of Appeals did not affirm the appellate division's findings on the merits, \(^{24}\) three issues will necessarily need to be resolved: (1) whether or not a sponsor has a contractual duty to sell shares; (2) what percentage of shares may a sponsor hold onto while establishing a viable co-op; \(^{25}\) and (3) what is a reasonable amount of time for the sponsor to sell such shares. The answers to these questions will establish guidelines so that the holding could be applied to other cooperative conversion disputes. This Comment analyzes the issues raised by the appellate division’s holding \(^{26}\) and some of the potential effects of attempting to enforce such a duty if such a duty exists. \(^{27}\)

Part I of this Comment will analyze the rationale behind imposing the implied duty, and it explores alternative theories under which to base a sponsor’s implied duty to diligently sell unsold shares. There are several modes of analysis by which the

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\(^{23}\) Jennifer Realty, 98 N.Y.2d at 154, 773 N.E.2d at 501, 746 N.Y.S.2d at 136.

\(^{24}\) Notwithstanding the current debate, I argue that this is a fair assumption given the court's statement that "[a]t this preanswer stage of the litigation, we need not reach the merits of plaintiffs' contract cause of action and therefore do not address the issue of whether, as alleged, the sponsor impliedly promised to sell all its unsold shares." Id. at 154, 773 N.E.2d at 501, 746 N.Y.S.2d at 136.

\(^{25}\) The Court of Appeals spoke of the shareholders' expectation of "creating a viable cooperative." Id. at 154, 773 N.E.2d at 501, 746 N.Y.S.2d at 136. Therefore, much of the current discussion is focused on what constitutes a viable co-op and how a sponsor establishes one.

\(^{26}\) For further discussion on the ramifications of the holding, see Jay Romano, Little Clarity in Decision on Sponsors, N.Y. TIMES, Sept. 2, 2001, §11 (Real Estate), at 5.

\(^{27}\) While the discussion in this Comment is limited to New York law, this is an issue likely to come up in other states where the cooperative form of real estate ownership is highly utilized. In the United States, the cooperative form of housing is most prevalent in New York and Chicago. Co-ops are also found in Los Angeles, San Francisco, and Florida but with less frequency than in New York and Chicago. Most of the country, including many large cities, do not utilize the cooperative form of real estate ownership. See Kane, supra note 8, at 103–04.
court could have found such a duty; however, the implications of this duty remain the same regardless of how it is rationalized.

Part II addresses the question of what constitutes a viable cooperative corporation and the issue of what interval constitutes a reasonable time in which the sponsor must sell unsold shares. It discusses whether the requirement to sell within a reasonable amount of time applies only to vacant units or to all unsold shares. Further, it must be determined if market conditions should be taken into account in determining whether the sponsor has fulfilled his duty and, if they may not be taken into account, whether the sponsor is expected to sell at a loss, absorbing the cost himself. Part II concludes by stating that the sponsor does not have to execute a sale immediately upon vacancy in all circumstances; however, he has a duty to diligently market the vacant units in order to facilitate fulfillment of the shareholders' expectations even if this may result in a pecuniary loss.

Part III discusses the alarming reality that, if sponsors are unable to fulfill this duty, there is likely to be a large increase of sponsor default leading to severe political, social, and economic consequences. In the past, sponsors defaulted because economic conditions imposed unforeseeable hardships on them. The Martin Act, which aims to protect the unsophisticated purchaser, sought to incorporate safeguards to protect tenant shareholders by increasing their awareness of the financial aspects of the cooperative conversion process. Any court action that might incidentally lead to a dramatic increase in instances of sponsor default would be contrary to the public policy that underlies the Martin Act and the public protections that it promotes.

Finally, Part IV explores whether this is an issue best resolved by the legislature through amendment to section 352-eee of New York General Business Law ("section 352-eee"), or whether this is an appropriate situation for judicial law making. Ultimately I argue that this issue is not well suited for legislative determination, but rather it necessitates a more flexible approach that would be best evolved through case law. A compromise is proposed, which would entail legislative

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28 See Mollen, Sept. 12, 2001, supra note 20 (acknowledging comments that sponsors might be compelled to walk away, defaulting on their maintenance obligations in light of the Jennifer Realty holding).
enactment of an amendment to section 352-eeee, making it necessary for a sponsor to sell shares within a reasonable amount of time after conversion, and providing guidelines for the courts to follow in determining damages when non-compliance occurs.

I. THE COURT'S ANALYSIS AND ALTERNATIVE ANALYSES

In New York City, cooperative conversions are governed by 352-eeee. The widely accepted dual purpose of the statute is to set forth the rights of purchasing tenants and the duties that a sponsor has to the parties in occupancy at the time of the conversion. Yet on its face, the statute does not give any guidance regarding a sponsor's duty to sell shares beyond the first ninety days subsequent to effectuation of a plan; therefore, the appellate division had to look beyond the face of the statute in formulating its determination.


One of the main purposes of section 352-eeee is to protect non-purchasing tenants by giving them indefinite rights to occupancy. Another purpose is to protect tenants-in-occupancy from being displaced at the time of conversion by giving them the exclusive right to purchase their apartments for ninety days following the acceptance of the offering plan. See Godman, supra note 29, at 1349–50, 1350 n.13. The legislative findings support this, stating "that preventive action by the legislature in restricting rents and evictions during the process of conversion from rental to cooperative or condominium status is imperative to assure that such conversions will not result in unjust, unreasonable and oppressive rents and rental agreements affecting non-purchasing tenants." N.Y. GEN. BUS. LAW § 352-eeee (McKinney 1995) (Legislative findings of L.1982, c. 555, §1).

See 511 W. 232nd Owners Corp. v. Jennifer Realty Co., 285 A.D.2d 244, 246–47, 729 N.Y.S.2d 34, 35–36 (1st Dep't 2001) (acknowledging that "a sponsor's statutory obligations are primarily found in the Martin Act" and stating that the statute does not impose an obligation on the sponsor to dispose of unsold shares after the offering plan has been effectuated).
In light of the statute's failure to address the issue at hand in Jennifer Realty, the appellate division determined that it "must look to the offering plan and subscription agreement" in order to reach a conclusion in this case.\textsuperscript{32} Relying on the maxim that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement,"\textsuperscript{33} the court found an implied duty to sell within the offering plan.\textsuperscript{34}

The court did not have to turn to the offering plan to find such an implied duty, as there were alternative means available to reach the same end.\textsuperscript{35} For instance, because the Martin Act itself is rich with measures aimed at protecting tenants in the conversion process, the court could have easily found such a duty implicit within section 352-eeee.\textsuperscript{36} An example of the protective

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\textsuperscript{32} Id. at 247, 729 N.Y.S.2d at 36.
\textsuperscript{33} RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).
\textsuperscript{34} Jennifer Realty, 285 A.D.2d at 247, 729 N.Y.S.2d at 36. See supra notes 13–20 and accompanying text.

When a court is put into the position of supplying such an implied-in-law term, it relies primarily on the perceived expectations of the parties at the time of contract formation. See FARNSWORTH, supra note 2, § 7.9, at 458. Hence, the appellate division used commonly known goals of the shareholders to infer their expectations and incorporated them into the offering plan. Jennifer Realty, 285 A.D.2d at 247, 729 N.Y.S.2d at 36.

\textsuperscript{35} Both the New York Court of Appeals and the New York Appellate Division, First Department, have previously found that the sponsor of a cooperative conversion has a duty to "meet high standards of fair dealing and good faith toward tenants," but both courts failed to identify the source of this implied duty. See Vermeer Owners, Inc. v. Guterman, 78 N.Y.2d 1114, 1116, 585 N.E.2d 377, 378, 578 N.Y.S.2d 128, 129 (1991); Rossi v. Twinbogo Co., 232 A.D.2d 266, 267, 648 N.Y.S.2d 97, 97 (1st Dep't 1996) (citing Guterman and acknowledging the duty of good faith and fair dealing).

\textsuperscript{36} The statute uses the term "good faith" several times. The phrase "pursuant to an offering made in good faith without fraud" is found in both the definitions of "non-eviction plan" and "eviction plan," as well as in the criteria for declaring an eviction plan effective. N.Y. GEN BUS LAW § 352-eeee(1)(b), (1)(c), (2)(d)(i)
nature of the Martin Act is indicated by the legislative history which states that one of the reasons for this section of the Martin Act is to assure that tenants involved in the conversion process would not be displaced from their apartments in the event that they chose not to buy.\textsuperscript{37} More importantly, the legislative findings indicate that public policy was a paramount consideration in drafting of the statute.\textsuperscript{38}

Scholars have indicated that where “no law either prohibits... or explicitly authorizes [a right or duty], the issue should turn on its public policy ramifications.”\textsuperscript{39} Furthermore, the various clauses of section 352-eeeee are filled with public policy undertones.\textsuperscript{40} For example, there are many provisions directed at non-purchasing tenants, particularly those who are elderly or disabled, and those who are rent-regulated tenants.\textsuperscript{41} Statements such as “[n]o eviction proceedings will be commenced at any time against non-purchasing tenants for failure to purchase,”\textsuperscript{42} “[n]on-purchasing tenants who reside in dwelling units subject to government regulation... shall continue to be subject thereto,”\textsuperscript{43} and “[t]he rentals of non-purchasing tenants who reside in dwelling units not subject to government regulation... shall not be subject to unconscionable increases

\textsuperscript{37} See supra note 30. The legislative findings concede the importance of “protecting tenants in possession who do not desire or who are unable to purchase the units in which they reside from being coerced into vacating such units.” N.Y. GEN. BUS. LAW § 352-eeeee note (McKinney 1995) (Legislative findings of L.1982, c. 555, §1). Additionally, the appellate division has previously recognized these concerns, describing the “obsessing fear” that tenants have about being evicted in a conversion. Gilligan v. Tishman Realty & Constr. Co., 126 N.Y.S.2d 813, 818 (1st Dep't 1953).

\textsuperscript{38} Section 1 of the findings talks of both “public policy” and “public interest.” N.Y. GEN. BUS. LAW § 352-eeeee (McKinney 1995) (Legislative findings of L.1982, c. 555, §1).

\textsuperscript{39} Godman, supra note 29, at 1366; see also Bruce Czachor, Comment, Cooperative and Condominium Conversions in New York: The Tenant in Occupancy, 31 N.Y.L. SCH. L. REV. 763, 789 (1986) (discussing determinations founded on public policy).

\textsuperscript{40} See, e.g., N.Y. GEN. BUS. LAW § 352-eeeee(1)(c) (McKinney 1996 & Supp. 2002) (requiring “at least fifty-one percent” of the purchasing tenants to have signed written agreements “in good faith without fraud and with no discriminatory... inducements” before eviction of a non-purchasing tenant is permissible).

\textsuperscript{41} See id. § 352-eeeee(2)(c)(iii), (2)(c)(iv), (2)(d)(iii).

\textsuperscript{42} Id. § 352-eeeee(2)(c)(ii).

\textsuperscript{43} Id. § 352-eeeee(2)(c)(iii).
[in rent], indicate that the legislature’s overriding concern was that of protecting the public from fraudulent motives for conversion. In fact, a previous New York State attorney general contended that “the Martin Act should be construed broadly to protect fraudulent exploitation of the public generally.”

While the above quoted statements are admittedly aimed at protecting only non-purchasing tenants, they are indicative of a general public policy seeking to restrain sponsors. The text of section 352-eeee, combined with the legislative history and findings, reveals that the legislature was aware of the dangers that could ensue from a sponsor’s superior bargaining position. The various protections written into the Martin Act reveal the legislature’s desire to control the sponsor’s power so that he may not use it against the tenants—the tenants being the very people that are meant to benefit from the conversion process. The court could easily have used these underlying public policy concerns to conclude the existence of an implicit statutory duty of good faith and fair dealing on the part of the sponsor.

Another method by which the court could have found an implied duty is through the relationship of majority and minority shareholders. This analysis, however, proves more difficult because the standards that need to be met are more ambiguous, and the burden of proof placed on the minority shareholders is more stringent. The cooperative relationship can be analogized to a closely held corporation in which majority shareholders have a heightened fiduciary duty to minority shareholders. In spite of this heightened duty, many courts, including those in New York, still take a restrictive approach to fiduciary duties in

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44 Id. § 352-eeee(2)(c)(iv).
46 Although section 352-e(1)(b) of the General Business Law mentions that the offering plan must address the nature of the fiduciary relationship of the principals involved, there is no interpretation of this provision nor any indication how it might play out in disputes regarding the offering plan. N.Y. GEN. BUS. LAW § 352-e(1)(b) (McKinney 1996 & Supp. 2002).
47 See S. Pac. Co. v. Bogert, 250 U.S. 483, 487–88 (1919). As there is no case law interpreting this, the peculiar type of corporation formed by a cooperative conversion seems to be best analogized to a closely held corporation. A closely held (or close) corporation is one “whose stock is not freely traded and is held by only a few shareholders.” BLACK’S LAW DICTIONARY 341 (7th ed. 1999). A cooperative corporation seems to satisfy these general characteristics.
closely held corporations. For instance, in *Orloff v. Weinstein Enterprises, Inc.*, plaintiff minority shareholders claimed that they were "denied an effective voice in management." The court concluded that, although the minority shareholders sufficiently proved "exclusion from having an active voice in important corporate decision making," in order to prove a breach of fiduciary duty the minority shareholders would have had "to show that decisions made in [their] absence were either significant, or adverse to [their] interests." Thus it follows that in the *Jennifer Realty* situation, it may not be enough for the shareholders to prove that they were denied a voice in management because the sponsor held onto a substantial percentage of shares—entitling him to a substantial percentage of voting power in the corporation. The tenant shareholders might have to prove actual damages flowing out of this denial. Proving actual damages in the cooperative corporation context may be difficult, if not impossible.

Although there are many different analyses one might use to establish a sponsor's duty to sell unsold shares within a reasonable amount of time, it seems that the *Jennifer Realty* court chose the contractual approach because it is the one that most logically flows out of the circumstances, and it also has the clearest guidelines. Nonetheless, the practical effects of establishing this duty to sell unsold shares within a reasonable time remain the same regardless of how it is rationalized, and the imposition of such a duty finds support in many different areas of the law.

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49 247 A.D.2d 63, 677 N.Y.S.2d 544 (1st Dep't 1998).

50 *Id.* at 65, 677 N.Y.S.2d at 545. Here a closely held corporation was involved, with the majority defendants holding fifty-seven percent of its shares, and the minority defendants holding thirty-three percent. The remaining ten percent of shares were owned by the plaintiff. *Id.* at 64–65, 677 N.Y.S.2d at 544.

51 *Id.* at 67, 677 N.Y.S.2d at 546.

52 *Id.*
II. ASSESSING THE REASONABLE TIME REQUIREMENT FOR SELLING SHARES

A. Application of Law

Traditionally, disputes arising under landlord-tenant agreements have not been subject to the same theories of resolution as other contractual breaches. For years, courts have been dueling over the benefits of striking down this approach and resolving such claims under modern contract theory. In this case, the proper analysis is under contract theory.

The shareholders in Jennifer Realty are entitled to a proprietary lease of a particular unit in the building by way of their ownership of shares. The fact that occupancy rights are granted by way of a lease means that, in the eyes of the law, each shareholder is in the position of tenant in relation to the cooperative corporation, which functions as a landlord. Two points make this concern a negligible factor with regard to analyzing the instant case under contract theory. First, the

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53 In the traditional analysis, courts have utilized the special rules governing real property transactions to resolve controversies. These special rules are based on the view that a leasehold is a present transfer of an estate in real property. Such a traditional analysis severely limits the rights and remedies available to tenants. For example, there can be no finding of implied warranties, and a landlord has no duty to mitigate damages. See Holy Prop. Ltd. v. Kenneth Cole Prod., Inc., 87 N.Y.2d 130, 133, 661 N.E.2d 694, 696, 637 N.Y.S.2d 964, 966 (1995) (reaffirming the old doctrine as it applies to commercial property transactions).

54 See id. at 133, 661 N.E.2d at 696, 637 N.Y.S.2d at 966. Although currently unsuccessful in New York State, the movement toward reform in New York first became prevalent in the 1970s. See LeFrak v. Lambert, 89 Misc. 2d 197, 200–03, 390 N.Y.S.2d 959, 962–64 (N.Y. Civ. Ct. Queens County 1976) (discussing a need to revise the approach to lease disputes), modified, 93 Misc. 2d 632, 633, 403 N.Y.S.2d 397, 398 (Sup. Ct. App. T. 2d Dep't 1978) (holding that modernizing concepts of landlord and tenant law was not necessary in this case); Parkwood Realty Co. v. Marciano, 77 Misc. 2d 690, 691, 353 N.Y.S.2d 623, 624–26 (N.Y. Civ. Ct. Queens County 1974) (maintaining that there is no longer a good reason for the distinction and recognizing the growing trend toward reading mutual contract obligations into residential leases). For further discussion of the traditional analysis and recognition that a contractual approach would best serve modern disputes, see Javins v. First Nat'l Realty Corp., 428 F.2d 1071 (D.C. Cir. 1970). Today, New York State strongly adheres to the historical distinction. See Holy Prop. Ltd., 87 N.Y.2d at 133, 661 N.E.2d at 696, 637 N.Y.S.2d at 966 (holding that leases are not subject to the general contractual rule); Wallis v. Falken-Smith, 136 A.D.2d 506, 506, 523 N.Y.S.2d 827, 828 (1st Dep't 1988) (stating that there is no need to reconsider the traditional approach).

55 See supra note 8.
foundation of the present dispute is the offering plan—a contract fundamentally concerned with setting out the details of the conversion process and the transfer of shares, not with the granting of a proprietary lease. Second, the New York Court of Appeals has concluded that, in disputes between a shareholder and the cooperative board regarding issues arising from the shareholder’s proprietary lease, the goals of a cooperative corporation “are best served by a standard of review that is analogous to the business judgment rule.” This conclusion largely negates the idea that the relationship between the shareholder and the cooperative corporation is simply one of the conventional landlord and tenant. Case law has proven this notion untrue, even when dealing with tenancy-like issues that arise in the relationship. Therefore, the analysis in the subsequent sections will focus heavily on traditional contract theory for resolution of the issues involved.

B. Reasonable Time and Consideration of Market Conditions

Ascertaining the correct standard of “reasonableness” in any given set of facts has always been a struggle for the courts. Such a standard inevitably fluctuates depending on the circumstances of the parties, and its determination is generally dependent on the expectations of the parties at the time of contracting. What is “reasonable” in a specific case is by and large a matter of law.

56 See 511 W. 232nd Owners Corp. v. Jennifer Realty Co., 285 A.D.2d 244, 247, 729 N.Y.S.2d 34, 36 (1st Dep't 2002) (“An offering plan is a contract between the sponsor and the unit purchasers. Its purpose is to sell cooperative apartments within a building.”) (citation omitted); see also 4 WARREN'S WEED NEW YORK REAL PROPERTY § 3.02 (4th ed. 2001) (stating that the offering plan is to contain “a fair summary of all material aspects of the offering”).


58 See FARNSWORTH, supra note 2, § 3.28, at 211.

59 See id. at 212.

60 See id. § 7.9, at 458.

61 See Lefrak v. Lambert, 89 Misc. 2d 197, 200, 390 N.Y.S.2d 959, 961 (N.Y. Civ. Ct. Queens County 1976) (finding that “as a matter of law 17 months is an unreasonable period of time” to leave a middle class apartment vacant) (emphasis
In *Jennifer Realty*, it is apparent that the interests of the opposing parties are in conflict; tenants generally seek conversion because of their motivation to become self-regulating and to achieve a community of permanent, as opposed to transient, unit occupiers while sponsors seek conversion in hopes that the profit they gain by selling units to tenants will heavily outweigh the profits they would have received by collecting rent. It follows that the expectations of the parties are in line with their respective interests. Shareholders expect the unsold shares to be sold as soon as possible because nothing in the conversion process indicates when to sell or even whether to sell shares at all. On the other hand, sponsors might wholly expect that they are authorized to use their discretion in selling the unsold shares so that they may do so when it is their best interests to sell. They would want to hold on to the units either indefinitely or until they can receive the highest possible market price upon selling. Sponsors may also want to be able to retain their units if they are able to make more money by renting them rather than selling them.

The law that governs the duties of good faith in a contractual situation is helpful in solving the question of what constitutes a reasonable time. An obligation of good faith and fair dealing in the performance of a contract is one of the most frequently implied terms in contract law. The Restatement of

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62 See *supra* notes 16–18 and accompanying text.

63 See *Godman, supra* note 29, at 1347–48. Another recognized goal of some sponsors of cooperative conversions is a type of "deregulation" of the building. By buying out rent-regulated tenants or waiting for them to leave the building, the sponsor is able to free up those regulated units so that in the future, a shareholder who would like to rent out the apartment can do so at market value, which might be at a significantly higher rent than that which a rent regulated tenant would pay. *See Kane, supra* note 8, at 121–22.

Note that the sponsor may buy out the rent-regulated tenant, becoming the shareholder to that unit, and sublet the unit to market rate tenants. This essentially allows the sponsor to remain in the position of landlord while quickly, easily, and profitably deregulating his building without risk of acting unlawfully.

64 It has become a common practice for sponsors to hold units and rent them at the going market rate for two reasons. First, it works to financially compensate for the low rent paid by rent controlled tenants who continue to reside in the building. Second, the sponsor might not be able to otherwise cover maintenance costs. In such a situation, the sponsor might seek to use the money from market tenants to compensate for the shortfall. *See Romano, June 30, 2002, supra* note 22.

65 *See FARNSWORTH, supra* note 2, § 7.17, at 504 (stating that this term of good
Contracts dictates that such an obligation is implied in every contract.\(^66\)

While the scope of the term “good faith” varies with its context, it has been read to embrace “‘any promises which a reasonable person in the position of the promisee would be justified in understanding were included.’”\(^67\) Also implied is a promise that neither party “shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.”\(^68\) Thus, from these two statements one can conclude that the sponsor has a duty of good faith in dealing with the plaintiff, and this duty encompasses selling the vacant units. It can also be concluded that the sponsor violated this duty by putting its own interests ahead of those of the tenant shareholders.\(^69\)

The tenants’ “fruits of the contract” are the benefits that cooperative ownership bring them. While the recognized “fruits of the contract” on the sponsor’s side, namely financial benefits, are just as legitimate as those on the shareholder tenants’ side, the shareholders “were justified in understanding” that the

\(^66\) See section 205 of the Restatement of Contracts, which is entitled “Duty of Good Faith and Fair Dealing” and provides that “[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.” The Uniform Commercial Code also recognizes the existence of such a duty. See U.C.C. § 1-203 (1978). Section 1-203 is entitled “Obligation of Good Faith” and provides that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” Id.

\(^67\) Rowe v. Great Atl. & Pac. Tea Co., 46 N.Y.2d 62, 69, 385 N.E.2d 566, 569, 412 N.Y.S.2d 827, 831 (1978) (quoting 5 WILLISTON, CONTRACTS § 1293, at 3682 (rev. ed. 1937)); see also N.Y. Univ. v. Cont'l Ins. Co., 87 N.Y.2d 308, 318, 662 N.E.2d 763, 769, 639 N.Y.S.2d 283, 289 (1995) (following Rowe by looking to what the reasonable insured person would understand the insurer’s promise to be). This would explain the appellate division’s acceptance of the plaintiff’s argument that the offering plan led them to believe that the sponsor would sell the unsold shares as quickly as possible after conversion. See supra note 9 and accompanying text.


\(^69\) See Dalton v. Educ. Testing Serv., 87 N.Y.2d 348, 389, 663 N.E.2d 289, 291–92, 639 N.Y.S.2d 977, 979–80 (1995) (synthesizing Rowe and Kirke to derive a comprehensive analysis). The Dalton court noted that “[w]here the contract contemplates the exercise of discretion,” there is a “promise not to act arbitrarily or irrationally in exercising that discretion,” but that the implication of good faith and fair dealing is limited when it is inconsistent with other terms of the contract. Id. at 389, 663 N.E.2d at 291–92, 639 N.Y.S.2d at 979–80.
sponsor promised that it would not do anything to sabotage the fulfillment of the tenants' reasonable motivation for entering into the agreement. In an extreme case like Jennifer Realty, failure to sell a majority of the apartments clearly constitutes an injury to the tenants' rights to realize the fruits of their contract and is therefore in violation of the contract. Even if relinquishing control of a majority of the apartments meant that the sponsor would have to face some economic loss, he should be obligated to do so.

The reason the sponsor may have to face some pecuniary loss is because of another frequently implied term—that of "best" or "reasonable" efforts. This term has been interpreted to mean that a party is required "to make such efforts as are reasonable in the light of that party's ability and the means at its disposal and of the other party's justifiable expectations." As indicated above, "[i]n every contract there ... exists an implied covenant of good faith and fair dealing." The implied duty of fair dealing actually reaches beyond mere good faith. Not only is one party required to refrain from impeding the other party's reasonable goals in formulating the contract but also, in most cases, affirmative action is required to meet the standard of "best efforts." Yet this duty is not any more clearly defined than the duty of good faith described above—"[b]est efforts' is a term 'which necessarily takes its meaning from the circumstances.'"
Such a duty of best efforts is implied with exceptional frequency in exclusive agency agreement situations, where it is often found that the exclusive agent has a fiduciary duty to uphold. It is proper to analogize the sponsor’s situation to an exclusive agreement because the sponsor is the only one who is able to sell the unsold shares—he is the only person who has control and discretion over them. The shareholders are relying solely on the sponsor to facilitate the realization of their goals. It has been conceded that “[u]nless [the exclusive agent] gave his efforts, [the party relying on him] could never get anything.”

More importantly, it would be irrational to infer that a party is placed at the mercy of his exclusive agent. Thus, in the type of situation that Jennifer Realty finds itself in, a duty of best efforts is necessarily implied.

Such a duty has not been fulfilled until a so-called “viable co-op” has been formed. Determination of what constitutes a viable co-op is a necessary inquiry in determining whether a sponsor has fulfilled his implied-in-law duty. Keeping in mind the underlying purposes and goals of a cooperative conversion, it would be safe to assume that a co-op cannot be viable until shareholders have a true voice in management, can obtain market rate financing, can sell their units at market rates, and until the building is no longer primarily occupied by transient tenants. One scholar has suggested five elements to consider in ascertaining whether a cooperative corporation is “viable”:

1. “Liquidity in Sales and Debt”

which it was to be conducted.”).

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77 See Hearn v. Charles A. Stevens & Bro., 111 A.D. 101, 106, 97 N.Y.S. 566, 569–70 (1st Dep’t 1906) (“[T]he fact that a construction...place[d] one of the parties entirely at the mercy of the other may properly be taken into consideration.” (citing Russell v. Allerton, 108 N.Y. 288, 15 N.E. 391 (N.Y. 1888))).
79 “A viable co-op is a co-op that is run by the residents of the building for the benefit of the cooperative and its cooperative purchasers.” Romano, June 30, 2002, supra note 22 (quoting Beatrice Lessner, attorney for 511 West 232nd Owners Corp.).
80 For the proposal and expansion of these five factors, see Jacobs, supra note 22.
81 Id.
This considers the ability of the shareholders to sell their units or refinance their cooperative loans. Furthermore, it also considers whether the cooperative corporation itself is forced to refinance its underlying mortgage on unfavorable terms.

2. “Control of the Cooperative Corporation.”

The Martin Act requires sponsors to surrender control of the board within five years after the cooperative corporation has been established. This has been interpreted to mean that “after the five years have expired, the sponsor cannot use its voting rights to elect a majority of directors nominated or designated by it.”

3. “Rentals to Sales” Ratio.

This undoubtedly has an impact on whether or not the cooperative is “viable.” The greater the amount of transient tenants, the greater the wear and tear on the building, increasing maintenance fees. Additionally, this compromises the stable environment that the shareholders sought.

4. “Purpose of a ‘Cooperative Housing Corporation.’”

One of the purposes of a cooperative corporation is to provide residential housing for its shareholders. Therefore, it has been suggested that viability may be linked to fulfilling this underlying corporate purpose.

5. “Duty Not to ‘Abandon’ Plan.”

Statutorily, a sponsor may not abandon an offering plan once it has become effective. It is uncertain

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82 Id.
84 Sherbansky v. 117 W. 81st St. Tenants Corp., 238 A.D.2d 246, 247, 657 N.Y.S.2d 14, 15 (1st Dep't 1997); see also Welco Assocs. v. Gordon, 174 A.D.2d 58, 63, 578 N.Y.S.2d 547, 550 (1st Dep't 1992) (stating that there is no law that prevents the sponsor from electing a majority of the board as long as the five year limit has not run). Such issues have come up because sponsors will sell apartments to “friendly shareholders” in order to sustain voting power that will not be used to challenge management. See Jacobs, supra note 22. Such an abuse of power should prevent a cooperative corporation from being deemed viable. Id.
85 Jacobs, supra note 22.
86 See Kane, supra note 8, at 103 (stating wealthy apartment owners welcomed the ability to pick their neighbors); Riccardi, supra note 18.
87 Jacobs, supra note 22.
88 Id.
89 Id.
whether a sponsor can file amendments disclosing any material changes in the status of his financial condition to satisfy this duty.\textsuperscript{91} Arguably, however, the sponsor must do more than merely file these amendments to avoid abandoning the plan. If a sponsor can fulfill the statutory requirement by following the black letter of the law while abandoning the underlying policy behind it, then the result is essentially the same as if he had abandoned the plan itself.

Attempting to form a so-called “viable co-op” may mean sacrifice on the part of the sponsor. In many situations the sponsor, although allowed to give consideration to his own financial interests, will be required to sustain a slight loss in order to fulfill a duty of reasonable efforts.\textsuperscript{92} Thus, for example, where a publisher acts in its own interests and incidentally lessens the author’s royalties, “there may be a point where that activity is so manifestly harmful to the author, and must have been seen by the publisher so to be harmful,” as to justify a finding of breach.\textsuperscript{93} On the other hand, an exclusive agent is not required “to spend itself into bankruptcy,” even if it is the only way he will be able to fulfill his duty.\textsuperscript{94}

Following this analysis, it can be concluded that Jennifer Realty would be required to sell the unsold shares at less than their maximum potential market value, but Jennifer Realty would not be required to sell them at an exceptionally high loss. As stated above, “‘[b]est efforts’ is a term ‘which necessarily takes its meaning from the circumstances,’”\textsuperscript{95} which indicates that market conditions might be taken into account in assessing the sponsor’s responsibility.\textsuperscript{96} If the sponsor is so ill-fated as to


\textsuperscript{91} See Jacobs, supra note 22.

\textsuperscript{92} See Bloor v. Falstaff Brewing Corp., 601 F.2d 609, 614 (2d Cir. 1979) (analyzing a situation where the exclusive agent pursues its own economic interests which are contrary to those of the client).


\textsuperscript{94} Bloor, 601 F.2d at 614.

\textsuperscript{95} Bloor v. Falstaff Brewing Corp., 454 F. Supp. 258, 266 (S.D.N.Y. 1978), aff’d, 601 F.2d 609 (2d Cir. 1972); see supra note 74 and accompanying text.

be placed in a position where selling at the current market conditions would entirely undercut his goals in the transaction, the sponsor should not be required to sell.\textsuperscript{97}

It must be acknowledged that it is difficult to draw the line between a reasonable loss on the part of the sponsor and a loss that is great enough to qualify as unreasonable. The point at which the sponsor’s fiduciary duty requires the sustainment a loss and the point at which such a loss is determined to entirely undercut his goals in the transaction cannot be decided by a fixed standard or equation. Such a decision is best made on a case-by-case basis.\textsuperscript{98} Hence, in all instances the answer to such a question should lay within the court’s discretion.

The above analysis undoubtedly applies to vacant units. Suggesting that it should apply to currently occupied units, however, would be a very dangerous position. The Martin Act was explicitly designed to protect tenants who wish to remain lessees in the case of a cooperative conversion.\textsuperscript{99} While it seems that it would be acceptable for a sponsor to attempt to “buy out” a current tenant under the Martin Act, it would clearly be out of line with the express legislative purpose of the statute to conclude that a sponsor is required to do more than that in order to sell all unsold units to tenant shareholders. Because the statute is aimed entirely at protecting tenants’ rights, its purpose would be defeated by any determination that a sponsor has a duty to actively pursue the buy-out of a currently occupied unit to the detriment of the occupying tenant. Any other conclusion might encourage harassing and vexatious methods on the part of a sponsor to fulfill this duty, and many sponsors may undertake such means in order to comply with the new requirement.\textsuperscript{100}

\textsuperscript{97} Commentators have stated that although most sponsors initiated conversion with the intent to sell as many units as possible, changing market conditions may thwart such an intent. Because of poor market conditions, sponsors were unable to sell at a reasonable market price and found it more advantageous to hold onto units while continuing to rent them. Such actions are not necessarily fraudulent within the meaning of the Martin Act, and therefore, sponsors who undertook such actions should not be penalized. See Mollen, Aug. 28, 2002, \textit{supra} note 22.

\textsuperscript{98} It has been suggested that a sponsor should not have to sell if he cannot obtain the “outsider price,” that is “the purchase price that the sponsor establishes in the offering plan for nonresidents of the building.” Romano, June 30, 2002, \textit{supra} note 22.

\textsuperscript{99} \textit{See supra} note 30.

\textsuperscript{100} It has also been noted that a sponsor should not be penalized if he was
III. RISK OF SPONSOR DEFAULT

In response to the Jennifer Realty holding, sponsors have declared that, “if they are forced to sell unregulated apartments that generate significant income and retain the low-income-generating apartments that remain rent regulated, they may be compelled to walk away and default on their maintenance obligations.” The problem of sponsor default carries with it widespread economic and social ramifications for communities containing co-ops. A defaulted co-op may become run down leading to poor living conditions for tenants and depressing real estate prices for the entire neighborhood. It may also cause further economic hardship to tenant shareholders who would not be able to sell their shares in the corporation. Beyond that, sponsor default seriously undermines the Martin Act’s goal of protecting occupying tenants and tenant shareholders. Sponsor default has been described as “a co-op unit owner’s worst nightmare.” It has always been a serious concern among co-op corporations and tends to be a sponsor’s response to difficulties in keeping up with maintenance and loan payments. Fluctuations in sponsor default rates are often erratic; for example, in the period of 1989 to 1993, the number of cooperative sponsors that went into default quadrupled.

The effects of sponsor default on tenants can be severe and even devastating. While the remedy for default of a single unit owner is relatively simple, usually consisting of foreclosure by the lender and eviction by the co-op board, it is not that simple when a sponsor retaining ownership of units defaults. In this situation, the tenant shareholders will be forced to take over payments on the building. They will usually be forced to pay special assessments in order to keep up payments on the

unable to sell an apartment that has been occupied by a rent-regulated tenant. See Romano, June 30, 2002, supra note 22.
103 See id. (discussing the relationship between co-op sponsors and owners and the legal and practical effects of sponsor default).
104 See id. at 349.
building mortgage and to maintain services. Often, they are financially unprepared to undertake such an obligation. In the case where these payments are not met, the result will be a default on the cooperative’s underlying mortgage. The risk of default is even greater in those instances where there is an extremely high percentage of sponsor owned units, strapping the tenant shareholders with extraordinarily high assessment fee payments. Here default becomes almost inevitable.

Requiring the individual tenant shareholder to engage in such extreme remedial measures if the sponsor defaults is unfair to the tenant shareholders. Additionally, putting individual tenant shareholders at such a risk violates the underlying principles of the Martin Act. “As early as 1926, the purpose of the Martin Act was stated as being ‘to prevent all kinds of fraud in connection with the sale of securities . . . whereby the public is fraudulently exploited.’” As a result, New York State passed legislation that is intended to prevent a high incidence of default. The registration and disclosure requirements found in the 1960 legislation were meant to promote the same purposes that are implicit and explicit in the Martin Act.

The legislation takes a three-pronged approach. The first prong carries a requirement that sponsors submit a comprehensive disclosure of their financial status so that purchasers may make informed decisions about how much risk

106 See Lim, supra note 102, at 355.
107 See id.
108 See id. at 356 (discussing the cooperative corporation’s options where a sponsor goes into default); see also Peter Grant, Banks Assume Keep Obligations of Big Sponsor, CRAIN’S N.Y. BUS., Feb. 26, 1990, at 3 (discussing alternative remedies in sponsor default situations).
109 See Di Lorenzo, supra note 8, at 46 (quoting People v. Federated Radio Corp., 244 N.Y. 33, 38, 154 N.E. 655, 657 (1926)).
111 See Di Lorenzo, supra note 8, at 46–48 (discussing the legislation, its history, and its effects on cooperative offerings).
112 The new legislation in effect today is threefold and includes (1) a change in sponsor disclosure rules, requiring sponsors to more comprehensively report their financial status to potential purchasers; (2) the creation of a new mechanism in every new co-op offering plan permitting co-ops to collect rents directly from non-purchasing tenants in sponsor-owned units; and (3) the use of the Federal Condominium and Cooperative Conversion Protection and Abuse Relief Act in the co-op scheme to allow co-ops to terminate sponsors’ self-dealing leases.

Lim, supra note 102, at 371.
the transaction would involve.\textsuperscript{113} Second, the legislation includes a mechanism in every new co-op offering plan that allows the cooperative corporation to collect rent directly from non-purchasing tenants in sponsor-owned units. This is deemed to be more secure than having the rent money go to the sponsor first and then to the cooperative corporation.\textsuperscript{114} Third, the Federal Condominium and Cooperative Conversion Protection and Abuse Relief Act may be used to allow cooperative corporations to terminate sponsors’ self-dealing leases.\textsuperscript{115}

The risk of sponsor default is real, and the protections provided in the Martin Act may not be enough to offset this risk. In future considerations of a sponsor’s duties, the courts and the legislature must be mindful to provide added safeguards against sponsor default and to avoid inducing such default through their decisions and legislation.

\section*{IV. A Matter for the Legislature?}

While the Jennifer Realty court made a valiant effort to resolve the ambiguity inherent in New York’s current cooperative conversion law, its holding was undoubtedly vague, lacking adequate guidance for application in future cases. Perhaps the appellate division was merely trying to instigate a revision of New York General Business Law section 352-eeee. Such an instance of legislative revision induced by court decision in New York has occurred in the not too distant past.

Following the 1989 decision of Braschi v. Stahl Associates Co.,\textsuperscript{116} the New York State Legislature responded to the court’s decision by making a statutory revision. In Braschi, the New York Court of Appeals held that the term “family,” as contained in the New York City Rent and Eviction Regulations, could reasonably include “those who reside in households having all of the normal familial characteristics” but are not family in the traditional sense of being related by blood or marriage.\textsuperscript{117} The

\textsuperscript{113} Id. at 371–72.
\textsuperscript{114} Id. at 372–73.
\textsuperscript{115} Id. at 373–75.
\textsuperscript{117} Id. at 211–12, 543 N.E.2d at 54–55, 544 N.Y.S.2d at 789, 790 (finding same sex life partner is a “family member” entitled to the non-eviction protections of the rent control laws based upon a showing of “the exclusivity and longevity of the relationship [and] the level of emotional and financial commitment”). In formulating this decision, the court relied heavily on the legislative intent of the regulatory code,
legislature subsequently took its cue from the Court of Appeals and, in 1997, revised the statute, which now includes a definition of “family member” and extends this definition to include the interpretation of the Court of Appeals.\(^\text{118}\) It is possible that the appellate division, in deciding \textit{Jennifer Realty}, was trying to influence the legislature in the same way that the Court of Appeals did in \textit{Braschi}.

But would strict guidelines regarding a sponsor’s duty and the circumstances in which he might be found in breach be the best solution for this problem? The answer, arguably, is no. Such a determination needs to be fact sensitive. If the legislature were to prescribe strict terms for finding fiduciary violations, it would be difficult if not impossible to provide the necessary flexibility in a statute. In making determinations such as whether or not a sponsor’s economic interest would be undercut by selling at current market conditions, it is imperative that case specific factors such as market conditions, selling price, the sponsor’s projected loss, and the number of vacant units at the time of conversion are taken into account. No statute could adequately cover and provide a remedy for all possible situations that might arise.

Resolution of this issue might best be achieved through a comprehensive development of case law.\(^\text{119}\) Court decisions that expand on the principles underlying the decision in \textit{Jennifer Realty} and set flexible standards for application might be the most workable way to vindicate the rights of the shareholders in cooperative conversion situations while allowing for special circumstances to ease the burden that the sponsor might have to carry. The counter-argument to this method is that it would

determining that the “measures were designed to regulate and control the housing market so as to ‘prevent . . . hardship and dislocation.’ ” \textit{Id.} at 52 (internal quotation omitted).

\(^\text{118}\) See N.Y. COMP. CODES R. & REGS. tit. 9, § 2204.6(d)(3)(i) (2001); Rent Stabilization Ass’n v. Higgins, 83 N.Y.2d 156, 166, 630 N.E.2d 626, 629, 608 N.Y.S.2d 930, 933 (1993) (noting that months after the \textit{Barachi} decision the meaning of “family member” in the rent control regulations was enlarged to include “[a]ny other person . . . who can prove emotional and financial commitment, and interdependence”).

\(^\text{119}\) It has been noted that future litigation will be necessary to determine whether, under the facts of each specific offering, a sponsor has sold enough shares to create a viable cooperative corporation. \textit{See Jacobs}, \textit{supra} note 22. This is because the offering plan specific to each cooperative corporation will need to be analyzed. \textit{See Mollen}, Aug. 28, 2002, \textit{supra} note 22.
increase litigation flowing through the courts and subsequently place such a heavy burden on the judges and the system that it would undermine judicial efficiency.\textsuperscript{120} Yet, such undesirable consequences may also result from legislation that is too vague or too stringent to allow reasonable application and just results.

The optimal resolution might be a general legislative mandate that would specifically require sponsors to market unsold shares within a reasonable amount of time. Such a general mandate could either be silent on the precise details of the duty, leaving them to the courts to work out, or the legislature could spell out guidelines in the mandate that would provide useful guidance to the court in determining whether the sponsor has fulfilled his fiduciary duty to sell the unsold shares. These guidelines should be considerations that the legislature deems to be important in formulating the decision. For example, controlling guidelines might include what percentage of shares a sponsor may own during each year subsequent to conversion and the maximum percentage of loss a sponsor may be forced to endure in selling shares before the loss would be considered unreasonable.\textsuperscript{121}

\textbf{CONCLUSION}

While the \textit{Jennifer Realty} court had many means available to find an implied duty on the part of a sponsor to sell unsold shares, finding such a duty in the offering plan was the least controversial method. Whatever method the court employed to

\textsuperscript{120} Litigation inspired by the appellate division's holding has already begun. At the end of August 2002, Justice LaCava for the supreme court tried \textit{Michelangelo Apartment Inc. v. 687 Associates}, a case in which a cooperative corporation instituted an action as a third party beneficiary of an offering plan. In that case, the plaintiff relied on \textit{Jennifer Realty} for standing. The cause of action was dismissed without prejudice on the basis that the plaintiff lacked standing to prosecute such an action. For the opinion, see \textit{Decision of Interest}, N.Y. L.J., August 28, 2002, at 24.

\textsuperscript{121} Those who advocate the imposition of a strict duty to sell shares should be aware of the possible implications. If a sponsor who is holding large blocks of unsold shares is suddenly forced to sell, it will place a glut of apartments on the market. Furthermore, because in a cooperative corporation a sponsor does not need to obtain board approval in order to sell units, prospective buyers will be more likely to buy from the sponsor rather than from a tenant shareholder, making it more difficult for such a tenant shareholder to sell his own unit. Another equally important consideration on the part of shareholders should be that the high rents that sponsors are able to charge for deregulated units offset the low rents they receive from rent regulated units. Being able to offset the cost of rent regulation is likely to reduce the incident of sponsor default. \textit{See Romano, June 30, 2002, supra note 22.}
find this duty ultimately has no effect on how the duty plays out. Traditional principles of contract interpretation apply, although the issue does fall largely under real estate law. Under these principles, the sponsor has both a duty of "good faith" and "best efforts" in acting in his capacity as an exclusive agent toward the other shareholders. This duty requires the sponsor make efforts to sell unsold shares, even if it means sustaining a pecuniary loss. The sponsor would only be allowed to refrain from marketing unsold shares when selling the shares would result in substantial monetary loss. Furthermore, to keep the sponsor's duty in line with the legislative purpose of New York's General Business Law section 352-eeee, this duty only applies to vacant units. In formulating and enforcing this duty, courts must be cautious to avoid instigating sponsor default, which would violate the principles underlying the Martin Act. Because determinations of whether or not the sponsor has fulfilled this duty is highly fact sensitive, it is best to develop standards through case law rather than attempt to encompass all possible situations in one statute.