

## HOW TO HANDLE PROBLEMS WITH A CO-OP'S BOARD OF DIRECTORS

Sometimes owning a co-op apartment can present problems. Not only can your neighboring shareholders cause you concern, but the Board of Directors can be difficult to deal with too. This pamphlet is intended to address the questions most frequently asked of the Attorney General's office by New Yorkers who live in cooperatives regarding problems with their Boards of Directors.

**Q. I'm confused about how much power the Board of Directors of my co-op has. What can it do and what can't it do? Are there any legal standards it must meet?**

A. Boards of Directors in cooperatives have two basic legal obligations. The Board must follow the co-op's internal rules (as set forth in the by-laws, the proprietary lease, the certificate of incorporation and the house rules). It must also exercise prudent business judgment in making decisions, just like any other corporate board.

**Q. Where can I find the co-op's internal rules?**

A. Copies of the original by-laws and proprietary lease (plus house rules, if any) can be found in the offering plan that was distributed when the building first converted.

**Q. What if there have been changes in the rules since then?**

A. Any changes should be contained in amendments to the offering plan. But if there are no unsold shares in the building or if no units are being offered for sale, it is possible that the offering plan is not current and might not contain an updated version of the co-op's documents.

**Q. If I can't find an offering plan, where can I find the by-laws and proprietary lease?**

A. A member of the Board of Directors or your managing agent may provide you with them. If not, another shareholder may have a copy to give you.

**Q. What kind of information is contained in these documents?**

A. The by-laws and proprietary lease will set forth the following:

When annual shareholder meetings and elections to the board of directors are held, and how notice is given.

How many seats the sponsor can have on the board of directors and when the sponsor must give up control.

Whether shareholders have the right to call extra or special meetings (a very valuable right if you wish to ask the board to focus on particular matters.)

The procedure for amending the by-laws.

The quorum for voting and whether cumulative voting is allowed. (Cumulative voting allows a shareholder to vote all his/her votes for only one director instead of apportioning the votes among the number of vacancies.)

Sublet provisions.

**Q. If something isn't specifically addressed in these documents, can the board do whatever it wants?**

A. No, there are legal restrictions. The Business Corporation Law (BCL) is the main New York State law which governs how co-op corporations must operate. The decisions made by courts in cases involving BCL provisions are the case law which interprets the statute.

**Q. Where can I find a copy of the BCL?**

A. The BCL is published as volume 6 of McKinney's Consolidated Laws of New York Annotated ("McKinney's") which can be found in law libraries, many lawyers' offices and in certain public libraries.

**Q. What does the BCL provide?**

A. Important provisions of the BCL, and the sections in which they are found include the following:

There must be an annual meeting of shareholders at which an election for directors is held. (BCL Section 602(b))

Shareholders must be allowed to vote by "proxy" (or substitute) if they do not attend the shareholders meeting. (BCL Section 609)

Any shareholder may demand that an election inspector be appointed in order to insure the fairness of the election. Board shall appoint and if they fail to, person at the meeting may appoint one or more person. (BCL Section 610)

Upon request, any shareholder is entitled upon five days written demand to examine a record of shareholders, and make extracts therefrom. (BCL Section 624(b))

The corporation must keep minutes of shareholder meetings and correct, complete records of names and addresses of shareholders which it must make available for inspection by a shareholder or the shareholder's agent or attorney. (BCL Section 624) There is no requirement, however, that minutes of board meetings be made available.

Any shareholder may, upon request, receive an annual balance sheet and profit and loss statement for the past fiscal year. (BCL Section 624(e)) Be aware that these are frequently not prepared until several months after the end of a fiscal year. Also, offering plans should contain a commitment by the sponsor to prepare annual certified financial statements and distribute them to all shareholders as long as the sponsor is in control of the board. If the sponsor continues to sell, it must include such statements in amendments to the offering plan.

Any director may be removed for cause (that is, a good reason). If the certificate of incorporation or by-laws so provide, a director may also be removed without cause. (BCL Section 706)

If a director has a substantial financial interest in a contract or transaction, this must be disclosed to the board. Usually that director cannot vote on that contract or transaction. (BCL Section 713)

Any officer may be removed with or without cause by the Board. (BCL Section 716)

Directors must act in good faith, undivided loyalty and with prudence for the good of the corporation. They are, however, entitled to rely on information, reports and financial statements which are prepared by officers, committees, employees or outside professionals (like accountants or lawyers). (BCL 717)

Shareholders may sue directors and officers for misconduct. (BCL Section 720)

**Q. What's the best approach when the Board of Directors is not complying with either the BCL or the co-op's internal rules?**

A. A shareholder should tactfully point out this lack of compliance to the Board, expressing the expectation that the matter will be corrected. Sometimes that is all that is needed to solve a problem.

**Q. What if the Board won't respond to an oral request?**

A. You should write a letter to the Board. It should be factual, brief and not hostile. Keep copies of any letters that you send, and notes of telephone conversations (date, time, who called whom, and the gist of the conversation) in case the matter is not quickly resolved.

**Q. Should I do this on my own or get together with other shareholders?**

A. An attempt to influence the Board is always more persuasive if it is presented by a significant number of shareholders. If your problem is one that will affect others too, it is worth organizing the other shareholders. If you do, and the attempt to change the situation is not successful, the organized group can always seek to elect new directors at the next annual meeting.

**Q. What if the Board still doesn't respond to my complaint. Should I hire a lawyer?**

A. If the situation is serious enough, you may want to retain a private attorney. However, keep in mind the following:

It is a good idea to select someone with experience in handling co-op shareholders' problems. You could begin looking for an attorney by talking with shareholders in your co-op or other co-ops or with attorneys in other specialty areas. If this fails, you may wish to contact a local Bar Association for referrals.

Some lawyers will not charge for a single initial consultation or will charge only a minimal fee.

Most lawyers will attempt to resolve any matter through negotiation before considering litigation, since litigation is costly and usually lengthy. Litigating against the Board of a co-op, people with whom one lives, can also be very unpleasant.

**Q. How long can a sponsor control the Board of Directors?**

A. Co-ops are generally established by a sponsor which files an offering plan with the Attorney General's office and then can sell co-op shares to the public. When the co-op becomes effective (established), the sponsor usually owns most of the shares and thus controls the Board of Directors. In most cases the Attorney General requires sponsors to promise, in the offering plan, that they will give up their control of the Board of Directors after they sell over fifty percent of the shares, or after five years have passed since the closing, whichever comes first.

**Q. What does giving up control of the Board of Directors actually mean?**

A. It means that the sponsor cannot designate or nominate the majority of the directors. But a sponsor is not prevented from voting its shares for shareholders who have similar views, as long as the shareholders are not on the sponsor's payroll or otherwise given money by the sponsor.

**Q. How can the Attorney General's office help me?**

A. The Attorney General's office regulates the offer and sale of real estate securities (which includes shares in co-ops) by the sponsor. If the sponsor of the co-op is still controlling the Board of Directors or is not keeping the commitments which it made in the offering plan, the Attorney General's office may intervene on your behalf.

**Q. Does that mean that the Attorney General's office cannot help me unless I'm having a problem with the sponsor?**

A. Not necessarily. If a bank is threatening to foreclose on an underlying mortgage, for instance, the Attorney General's office may be able to intervene whether or not the sponsor is involved.

**Q. How should I contact the Attorney General's office?**

A. Send a letter to:       Real Estate Finance Bureau,  
                                  New York State Department of Law,  
                                  120 Broadway (23rd Floor),  
                                  New York, New York 10271.

We hope that the above answers have been helpful in figuring out solutions to problems with a co-op's Board of Directors. However, keep in mind that if serious problems arise, which the Board is not addressing, such as a bank threatening to foreclose on an underlying mortgage or a sponsor's failing to pay maintenance on unsold shares, it is important to act swiftly. Often such problems can be resolved, relatively simply, if shareholders organize and act right away.

Remember that members of co-op boards are usually other shareholders who are serving without pay. They generally want to resolve problems and keep peace in the building.

Good luck!

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Attorney General of the  
State of New York

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## **QUESTIONS AND ANSWERS**

**State of New York  
Office of the Attorney General  
Real Estate Finance Bureau  
120 Broadway, 23<sup>rd</sup> floor  
New York, N.Y. 10271  
(212) 416-8121**

**<http://www.ag.ny.gov/realestate/realestate.html>**