

MEMORANDUM

TO: REF ATTORNEYS, PARALEGALS, LAW STUDENTS

DATE: 10/16/91

FROM: MARY SABATINI DISTEPHAN *MDS*

RE: LENDER TAKEOVER (Replaces memo dated 1/14/91)

The Bureau has received a number of requests for guidance from lenders which become owners of either unsold shares in cooperatives or unsold units in a condominium. These lenders, whether they be banks or individuals, question their status and ask whether they have any obligations with regard to the offering plan.

This memo is written to help clarify these issues.

FORECLOSURE PROCEEDINGS

When a lender forecloses on shares held as security, pursuant to the Uniform Commercial Code, or on condominium units, pursuant to the Real Property Actions and Proceedings Law, and all shares or units are actually sold at the court-ordered auction to bona-fide third-party purchasers, the lender has no filing obligation pursuant to the General Business Law. The lender is legally foreclosing a lien.

BULK TRANSFER TO A "NEW SPONSOR"

If a lender, which either through foreclosure (when not all shares or units are sold at auction) or via a deed in lieu takes title to unsold shares or units, does not offer such shares or units for sale, and subsequently transfers in bulk to one or more purchasers who will take part in a public offering, such lender has no filing obligation pursuant to the General Business Law. (Of course, the new bulk purchaser(s) will be deemed to be a sponsor(s)).

LENDER MAKES OR TAKES PART IN PUBLIC OFFERING

However, if the lender takes title (or in some cases, control) to the unsold shares or units by any means and engages in offering such shares or units to the public, the lender becomes a sponsor with all of the rights of a sponsor and/or holder of unsold shares with respect to its prospective offerees. Such lender must comply with all the regulatory requirements of a sponsor, including submission of back-up documentation (RI-1s, affidavit of prior public offerings, affidavit of net worth, Broker-Dealer Statement [M-10]) and filing requirements (amending the plan, filing a certification by the sponsor and the sponsor's principals). The lender-sponsor will be liable only prospectively for the disclosure in the plan. It is important, therefore, that the plan be accurate. Although prior purchasers can look only to the previous sponsor for compensation, the new sponsor will be liable to those who purchased subsequent to its taking title for any material misrepresentations, omissions or inaccuracies in the plan. Any compliance with legal

requirements promised in the offering plan, such as the funding of a reserve for capital repairs or replacement, must be continued by the new lender-sponsor, although the new sponsor will only be responsible prospectively and will not have to make up for the prior sponsor's wrongful acts or omissions. The new lender-sponsor need not continue to fulfill a promise which was gratuitously (not required by law) made by the former sponsor (e.g. promise of a maintenance rebate) so long as the plan is amended to disclose that such benefit is no longer being offered.

NOT A HOLDER OF UNSOLD SHARES

When shares of a coop are taken by a lender due to a sponsor default, the lender cannot be considered a traditional "holder of unsold shares". That is because the transfer lacks the key elements of a "holder of unsold shares": designation of the new holder by the sponsor and sponsor's guarantee of the holder's financial obligations. Since, in this scenario, the sponsor can no longer qualify as a sponsor with the financial ability to guarantee, the new holder must stand on its own financial ability. The lender-sponsor must submit an affidavit of net worth, whereas a holder of unsold shares need not submit this document since its financial obligations are guaranteed by the sponsor. Otherwise there is no difference between a holder and a sponsor. This distinction does not bear on the liability of either a sponsor or a holder who fails to provide accurate and complete disclosure. The liability is the same. The rights of this new sponsor, however, are identical to those it would have had if it had been the original sponsor or holder of unsold shares. Along with the duty to file amendments and other obligations of a sponsor flows the right in a coop to be able to sell, transfer or sublet without board approval.

PROHIBITED ACTS OF FRAUD

In any transfer of ownership of shares or units, whether a lender or any other person that succeeds in title or control has an obligation to amend the offering plan or not, such person is liable if he/she makes a false representation or commits a fraud or other illegal act as proscribed by Section 352-c of the General Business Law.

This memo is intended to clear up most questions but there certainly will be variations with which this memo does not deal. Refer such questions to me if the need arises.

MSD:sg