19 Misc.3d 1125(A)
Unreported Disposition
(The decision is referenced in
the New York Supplement.)
Supreme Court, New York County, New York.

Joanne PELLO, Plaintiff,
v.
425 E. 50 OWNERS CORP., Gary Barbanel, individually, and as President and Director of 425 E. 50 Owners Corp., Elizabeth Mason, individually, and as Treasurer and Director of 425 E. 50 Owners Corp ., Sharla Bailey Kidder, individually, and as Secretary and Director of 425 E. 50 Owners Corp., Defendants.

No. 107442/07

March 31, 2008.

Attorneys and Law Firms

Nadel & Ciarlo, PC, New York, for plaintiff.

Marin Goodman LLP, New York, for defendants.

Opinion

WALTER TOLUB, J.

***1** In what is—hopefully—the last sally in a particularly internecine litigation (see also index nos. 101430/06, 112304/07) between plaintiff, a co-op owner and former treasurer of the cooperative corporation, and the corporation and its current officers and directors, plaintiff moves pursuant to Business Corporation Law ("BCL") § 501(c) to void a flip tax imposed by the cooperative's board of directors ("the board"), and for costs and attorney's fees related to the motion.

FACTS

Plaintiff purchased the shares appurtenant to unit 2 of a seven-unit cooperative building at 425 E 50th Street in Manhattan in August 2004. In February 2005, the board imposed a flip tax equal to two months' maintenance on all unit sales and sublets, and made the fee's payment by the owner or lessor a prerequisite to the board's approval of the sale or sublet.

Plaintiff was elected treasurer of the co-op in April 2005, but acrimony soon began. She was removed from that position by the board on October 1, 2005, allegedly for cause after she threatened to sue them, and was removed as a director in November 2005. In September 2006, the board increased the flip tax due on the sale of a unit to 2.5% of the selling price. Plaintiff listed her apartment for sale in December 2006 and obtained a purchaser, but refused to pay the flip tax. In turn, the board refused to approve the sale. Plaintiff brought this action seeking to nullify the flip tax both "derivatively in the right and for the benefit of 425 E. 50 Owners Corp. and representatively on her own behalf and on behalf of all other shareholders" (complaint, ¶ 12).

The gravamen of plaintiff's argument is that the board exceeded its authority in imposing the flip tax and violated BCL § 501(c) because neither the offering plan, by-laws nor proprietary lease authorized the board to impose such fee, and defendants' purported amendment of the bylaws never happened.

Flip Tax

As noted by the Court of Appeals, the imposition of a flip tax is not *per se* unreasonable or illegal provided that it is neither prohibited by a corporation's bylaws or proprietary lease, and does not violate the proportionality requirements as mandated by Business Corporation Law § 501(c)[1] (see, *Fe Bland v. Two Trees Management Co.* (66 N.Y.2d 556, 569 [1985]; *Meichsner v. Valentine Gardens Cooperative,* 137 A.D.2d 797, 798 [2d Dept 1988]). Transfer fees may also be validly adopted provided that they comply with the requirements of BCL § 501(c), and conform to the proprietary lease and are authorized by the bylaws and/or the proprietary lease (see, *Quirin v. 123 Apartments Corp.,* 128 A.D.2d 360, 363 [1st Dept 1987], app dism 70 N.Y.2d 796 [1987]). Furthermore, a transfer fee such as the one at bar, which is "proportional to the profit earned by the assigning shareholder" will not be held violative of BCL § 501(c) as long as it is again, authorized by either the corporation's bylaws or by the proprietary lease (see, *McCabe v. Hoffman,* 138 A.D.2d 287, 289 [1st Dept 1988]).

Co-op Documents

***2** Nothing in the original proprietary lease, the bylaws or the offering plan authorized the board to impose a flip tax. Contrary to defendant's first response to plaintiff's objection to the flip tax (exhibit A to plaintiff's reply papers), section 5.5 of the bylaws (exhibit E to moving papers), which provides that the "board shall have authority before an assignment or sublet of a Proprietary Lease or reallocation of shares takes effect as against the Corporation as lessor, to fix a reasonable fee to cover actual expenses and attorneys' fees of the Corporation, a service fee of the Corporation and such other conditions as it may determine, in connection with each such proposed assignments," does not authorize the board to impose a flip tax. Neither does § 16.1(iv) of the proprietary lease, which specifies as a condition precedent to a sale that "[a]ll sums due from the Lessee shall have been paid to the Lessor, together with a sum to be fixed by the Directors to cover reasonable legal and other expenses of the Lessor and its managing agent in connection with such assignment and transfer of shares," nor § O of the offering plan (exhibit D to moving papers), which contains a similar provision. "A fee on the transfer of shares in a cooperative apartment corporation (commonly called a 'flip tax') may not be imposed by the corporation's board of directions, when the bylaws of the corporation authorize the board to impose on such a transfer and assignment only 'a reasonable fee to cover actual expenses and attorneys' fees of the Corporation, a service fee of the Corporation and such other conditions as it may determine' " (*Fe Bland v. Two Trees Management Co., supra,* 66 N.Y.2d at 559; *Berglund v. 411 East 57th Corp.,* 127 Misc.2d 58, 58–59 [App Term, 1st Dept 1985], affd 118 A.D.2d 431 [1st Dept 1986], citing *McIntyre v. Royal Summit Owners,* 126 Misc.2d 930 [App Term, 1st Dept 1984]).

Nonetheless, this is not fatal to defendants. It is not necessary that the board's authorization stem from the original co-op documents. Imposition of a flip tax may be effected by amendment to the co-op bylaws, and it is not necessary that the proprietary lease also be amended (*Mello v. 79th Street Tenants Corp.,* 136 Misc.2d 73, 74–75 [Civ Ct, N.Y. Co, Lane, J, 1987], citing *Grossman v. 322 W 72 Apt. Corp.,* NYLJ Jan 28, 1987, p 38, col 5 [Sup Ct, N.Y. Co, Kirschenbaum, J]). Similarly, an amendment to the portion of the offering plan which sets forth the corporate bylaws, reflected in amended bylaws, obviates the need to amend the proprietary lease (*1326 Apartments Corp. v. Barbosa,* 147 Misc.2d 264 [Civ Ct, N.Y. Co, Solomon, J, 1990]).

Defendants do not claim to have amended the proprietary lease or the offering documents. They claim the flip tax is valid because the by-laws were amended (twice) to impose it. Plaintiff maintains that no such amendment took place. The dispositive question is thus whether the co-op documents were validly amended so as to authorize the board's imposition of an unequal flip tax and pass muster under BCL § 501(c).

Amendments to Bylaws

***3** Not unexpectedly, each side, through affidavits of individuals with personal knowledge of the facts (plaintiff for herself and defendant Sharla Bailey Kidder ["Kidder"], the board's secretary for defendants), gives very divergent versions of pertinent events to show how the by-laws were or were not properly amended to authorize the imposition of an unequal flip tax.

Defendants argue that the flip tax is valid because the co-op's "by-laws were specifically and properly amended in 2005 to include a specific for[sic] provision for the imposition of a flip tax" (Ettenger opposing affirmation, ¶ 3) and both the 2005 amendment (Kidder affidavit, ¶ 4) and the 2006 amendment (*id.,* ¶ 7) were unanimously voted for by the board. Both amendments were made before plaintiff entered into the sales contract (*id.,* ¶ 12), and at least one former shareholder paid the flip tax during plaintiff's tenancy on the board (Ettenger affirmation, ¶ 12). Defendants also argue that plaintiff made no objection to the flip tax until she tried to sell her apartment over two years after the tax was imposed. As discussed below, this argument, directly contradicted by the documentary evidence (exhibit A to plaintiff's reply papers), is unavailing.

Plaintiff, averring that defendants' opposition is "fraught with misstatements and outright lies" (plaintiff's reply affidavit, ¶ 2), insists that "[t]he truth is that the By-laws were never amended" (*id.,* ¶ 4; ¶¶ 8, 15). Plaintiff also argues that no prior notice was sent by the board to the shareholders and the board held no meeting or formal vote to amend the bylaws or institute the flip tax. According to plaintiff, defendants lie when they say notice of proposed 2005 amendment was attached to Kidder's undated memo (exhibit A to Kidder affidavit) because there were no attachments (plaintiff's reply affidavit, ¶ 7). In fact, plaintiff saw the two "proposed amendments" submitted by defendants (exhibits B and C to Kidder affidavit) for the first time in the course of this litigation.

The 2005 amendment in question purportedly added to the bylaws an Article 16, dubbed "Flip & Sublet Tax," which provided that:

> Flip & Sublet Tax Terms: A fee equal to 2 months[sic] maintenance for the apartment, shall be payable whenever an apartment is sold or sublet. The owner or lessor of the apartment is responsible for paying the fee to [the cooperative]. Approval to transfer ownership or to sublet will not be given until this fee is paid(exhibit B to Kidder affidavit). That Article 16 was then allegedly amended in pertinent part as follows:

Flip Tax (Reconfirmed and Amended September 27, 2006)

Flip Tax Terms: A fee equal to 2.5% of the selling price of the apartment, shall be payable whenever an apartment is sold.

The owner of the apartment is responsible for paying the fee to [the cooperative]. Approval to transfer ownership or[sic] will not be given until this fee is paid(exhibit C to Kidder affidavit). Both of these documents are freshly typed and stand alone on virgin paper rather than on a numbered page of the by-laws or a board resolution and are thus not conclusive on the issue of whether the by-laws were actually amended.

***4** The language of both clauses clearly provides for a flip tax; what is at issue is whether the board properly incorporated them into the bylaws.

The procedure for amending the by-laws is clearly set forth therein: They may be amended, enlarged or diminished either (a) at any Shareholders' meeting by vote of Shareholders owning two-thirds of the amount of the outstanding shares, represented in person or by proxy, provided that the proposed amendment or the substance thereof shall have been inserted in the notice of meeting or that all of the Shareholders be present in person or by proxy, or (b) at any meeting of the Board by a majority vote, provided that the proposed amendment or the substance thereof shall have been inserted in the notice of meeting or that all of the Directors shall have waived in writing notice of the meeting; provided, however, that the Board may not repeal a By-law amendment adopted by the Shareholders as provided above(exhibit E to moving papers, § 14.1).

As to the first possibility, amendment of the bylaws pursuant to § 14.1(a), the court finds that there was no meeting or vote of the shareholders. Kidder's claim that she personally spoke to all the shareholders prior to the board's imposition of the flip tax in 2005 and all including plaintiff were in favor of it (Kidder affidavit, ¶ 2), even if true, does not constitute the requisite shareholder meeting and approval. Under the by-laws, there is to be an annual meeting of shareholders (§ 2.1). In addition, the president, secretary or majority of the board, or holders of 25% of the shares, may call a special shareholders meeting at any time (§ 2.2). Written notice of all meetings must be given to shareholders between 10 and 40 days prior to the meeting (§§ 2.1, 2.2), but such notice may be waived (§ 2.4). No evidence of such waiver or meeting notice—much less a notice including the text of the proposed amendment as required by the by-laws—has been submitted to this court. The 'notice' which Kidder contends was given to all shareholders in November 2004 by the board is an undated memorandum to the co-op owners from "Sharla Kidder as fellow owner (not as board representative)" which sets forth her idea to impose a flip tax and asks the shareholders to "discuss this possible change" by "email[ing] or phon[ing] or slid[ing] a note under [her] door" because "it can be hard to schedule a coop meeting" (exhibit A to Kidder affidavit).

No other document is alleged by defendants to be a prior notice to the shareholders. This is consistent with plaintiff's averment that the only notice from the board pertaining to the 2005 amendment was of a *fait acompli* (exhibit B to plaintiff's reply papers), not of an intention. When notice to the shareholders is required, failure to provide such notice to all shareholders, even in a small building such as the one at issue here, will nullify a vote to institute a flip tax even when it was approved by more than the requisite number of shares (*Seif v. 72 Horatio Street Owners Corp.,* n.o.r., NYLJ Feb 6, 2002, at p 18, col 5 [Sup Ct, N.Y. Co, Cahn, J, 2002]). Similarly, plaintiff maintains that no prior notice was given to shareholders of the 2006 increase in the flip tax, no formal board meeting or vote took place (plaintiff's reply affidavit, ¶ 12), and shareholders learned of the increase in the flip tax only after it had been effected (*id.,* ¶ 13; exhibit D).

***5** Defendants contend that the 2005 amendment was authorized by § 14 .1(b), which allows the board, by majority vote, to amend the bylaws by itself upon specific prior notice of the board meeting or written waiver thereof. This argument is only partially supported by the evidence. Defendants have submitted (unattached to any affidavit or affirmation) a waiver of notice of the September 27, 2006 board meeting signed by the three officers who attended it. They have also submitted an unsigned loose piece of paper with no seal or other authenticating mark purporting to be the minutes of that meeting, in which it is noted that the "Board unanimously

voted in favor of increasing the flip tax upon sale of a unit to 2.5% of the sale price of the unit. The collecting of the tax is to be the responsibility of the seller of the unit. It was agreed that Sharla [Kidder] would draft a memo to this effect and distribute it immediately." There is no indication as to how or by whom the actual text of the amendment to the bylaws was to be drafted.

Even assuming that these documents are legitimate and suffice to legitimize the 2006 amendment pursuant to § 14.1(b) of the bylaws, defendants have not shown they had the authority to impose a flip tax, since no such documents have been provided with respect to the 2005 amendment, which was the one that first imposed the fee. Defendants have failed to produce a copy of either prior notice to the shareholders or minutes of the board meeting at which such amendment was allegedly authorized. Since the board's secretary is required by the by-laws to give all required notices and keep minutes of all board and shareholder meetings (exhibit E to moving papers, § 4.4) the court must conclude that either plaintiff is correct in her contention that the by-laws were never amended, or that the officers of the co-operative are so derelict in their duties and dismissive of their obligations under the by-laws that any action taken by them is meaningless. In examining the board's conduct with respect to the flip tax, the court is mindful that there are only seven units in the building, and that this presents an apparently irresistible temptation for the board to forego adherence to the corporate documents and instead run the building on an informal basis. However, while this may be understandable, it is not acceptable.

Of course, if the initial amendment to impose the flip tax in 2005 had been approved by the majority of the shareholders pursuant to § 14.1(a) of the bylaws, subsequent amendments to modify the amount of the fee could then be effected pursuant to § 14.1(b) (see, *e.g., Weigel v. 30 West 15th Street Owners Corp.,* n.o.r., 2008 WL 518140 [Civ Ct, N.Y. Co, 2008]). Arguably, the board's initial imposition of a flip tax in 2005 did not trigger BCL § 501(c) because the maintenance payments which constituted that flip tax bore a relationship to the number of shares associated with each unit. However, the board cannot circumvent the statute altogether by voting to "raise" that flip tax to an amount totally disproportionate to the number of appurtenant shares in a manner it could not have accomplished *ab initio* without violating the statute (compare *Reisch v. Greenwood Arms Cooperative Corp.,* 153 A.D.2d 844, 845 [2d Dept 1989]).

Proprietary Lease Requirements

***6** Finally, even assuming, *arguendo,* that both the 2005 and 2006 amendments were validly adopted by the board pursuant to § 14.1(b) of the bylaws, it would not have sufficed to impose an enforceable flip tax. As noted above, a co-op board may derive its authority to impose a flip tax from either the co-op bylaws or the proprietary lease, as amended. When applied to the actual documents involved here, however, this yields an apparent contradiction in the law. The alternative amendment process permissible for the bylaws (§ 14.1[b]) is nominal, yet an amendment to the proprietary lease must be in writing (Article 47) and approved by lessees owning at least 66–2/3% of the shares (§ 6.1). Hence, allowing the amendments to the bylaws purportedly effected by the three members of the board (holders of roughly 40% of the shares) to constitute an amendment to the proprietary lease would be nullifying the provisions of that lease. This the court cannot and will not do. "Inseparably joined, neither the corporate nor the leasehold attributes of the relationship [between the shareholders and the cooperative corporation] can be viewed in isolation from one another....

Even as to such normally corporate matters as the

authority of the board of directors, therefore, it is not just the bylaws that are determinative; the relevant provisions of the related documents must be read together" (*Quirin v. 123 Apartments Corp., supra,* 128 A.D.2d at 363, citations omitted). The rationale for allowing the flip tax to be imposed through the amendment of only one of the co-op documents is that all three are to be read together, and "considered in conjunction with each other" (*Zilberfein v. Palmer Terrace Cooperative, Inc.,* 18 AD3d 742, 744 [2d Dept 2005], app dism 7 NY3d 783 [2006]; *Reisch v. Greenwood Arms Cooperative Corp., supra,* 153 A.D.2d at 845, citations omitted). In other words, although the change to the terms of the proprietary lease may be effected indirectly through an amendment to the bylaws, the flip tax is not enforceable unless it is in harmony with the terms of the proprietary lease. In this case, it is not. When the proprietary lease and the bylaws at issue are read together, it is clear that any amendment to the by-laws which purports to materiallly amend the proprietary lease must be effected by shareholder vote pursuant to § 14.1(a) of the bylaws. "The general power of the board to operate and manage the cooperative does not permit it, unilaterally, to amend a material contractual provision of the proprietary lease in the absence of compliance with the amendment provisions contained therein" (*330 West End Apartment Corporation v. Kelly,* 124 Misc.2d 870, 873 [Sup Ct, N.Y. Co, L Cohen,

1984], affd 108 A.D.2d 1107 [1st Dept 1985], affd as modified *sub nom Fe Bland v. Two Trees Mgt. Co., supra,* 66 N.Y.2d 556). Although there are instances where the co-op board may amend the bylaws without shareholder approval to impose a flip tax (see N.Y. Condo & Coop Law § 10:5 [2007] for full discussion), this is not one of them.

***7** In short, the flip "tax was not specifically authorized in the proprietary lease or in the cooperative's by-laws. Nor was it approved as a modification or alteration of the lease or by-laws by a required affirmative vote of the shareholders" (*Berglund v. 411 East 57th Corp.,* 118 A.D.2d 431 [1st Dept 1986]). Thus, the amendments purportedly voted for by the board amount to nothing more than a mere board resolution. Absent an enabling amendment in the co-op documents, an unequal flip tax "provided for only in a resolution of the board of directors" cannot satisfy BCL § 501(c) (*Reisch v. Greenwood Arms Cooperative Corp., supra,* 153 A.D.2d at 845, citations omitted). Where, as here, the threshold set by the proprietary lease is higher than that set by the bylaws, the board cannot by mere resolution of the three individuals comprising it, without even notice to the shareholders, vest itself with the authority to impose a flip tax (see *McIntyre v. Royal Summit Owners, Inc., supra,* 126 Misc.2d at 932–933).

Since neither the original bylaws nor proprietary lease contain specific authority for the board's imposition of a flip tax or transfer fee, "and since defendant[s] failed to follow the proper procedures to effectuate an amendment of the Proprietary Lease authorizing such a ... surcharge," the flip tax should be voided *ab initio* and all improperly obtained fees returned" (*Zimiles v. Hotel des Artistes, Inc.,* 216 A.D.2d 45 [1st Dept 1995]). Furthermore, since the board acted in excess of its authority in enacting a flip tax without the express consent of the holders of 66–2/3% of the shares, defendants are also "answerable for those damages plaintiff can prove to have sustained as a result" (*Bailey v. 800 Grand Concourse Owners,* 199 A.D.2d 1, 3 [1st Dept 1993]).

On a last note, the 'flip tax' issue appears to be the final impediment to plaintiff's sale of her unit and severance of her connection to defendants. This court has already ruled in an earlier skirmish between the parties that if the board takes any action to prevent plaintiff from finally severing her relationship with the co-op, it cannot be said to be "acting fairly, impartially or in the best interest of the [b]uilding" (index no. 112304/07, mot seq. no. 001, p 4). Refusing to approve the transfer of her shares, even with a reservation of rights, would seem to be such an action. Thus, it is clearly in the best interests of all parties to allow plaintiff to sell her shares and sever all connections to the co-op.

Accordingly, plaintiff's motion is granted to the extent that it is hereby

ORDERED, ADJUDGED AND DECREED that the board exceeded its authority in imposing a flip tax in 2005 without the approval of the holders of 66–2/3% of the co-op's shares; and, it is further

ORDERED, ADJUDGED AND DECREED that such flip tax ("Article 16" of the bylaws) is hereby found to be null and void.

Plaintiff's second (breach of fiduciary duty) and third (breach of contract) causes of action for damages are hereby severed.

***8** Counsel shall appear in IA Part 15, Room 335, 60 Centre Street, New York, New York, on May 16, 2008 at 11:00 a.m. for the purpose of completing a pre-trial order specifying all discovery to be completed and setting forth a date for plaintiff to file a note of issue on her damage claims.

This decision constitutes the order and judgment of the court.

All Citations

19 Misc.3d 1125(A), 862 N.Y.S.2d 816 (Table), 2008 WL 1869651, 2008 N.Y. Slip Op. 50849(U)