

Allannic v Levin

2008 NY Slip Op 30011(U)

January 4, 2008

Supreme Court, New York County

Docket Number: 0601216/2006

Judge: Leland G. DeGrasse

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: LELAND DeGRASSE
Justice

PART 25

Cyrille Allanic

INDEX NO.

60/216-04

MOTION DATE

- v -

Paul Levin

MOTION SEQ. NO.

#003

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

~~THIS CASE IS DECIDED IN ACCORDANCE WITH~~
~~ACCOMPANYING MEMORANDUM DECISION.~~

JAN 04 2008

Dated: _____



J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

-----X
CYRILLE ALLANNIC, FREDERIKA BUXBAUM
ALLANNIC and JARROD FONG, Individually and as
shareholders of 682 Sixth Avenue Housing
Development Fund Corporation, suing in the right of
682 Sixth Avenue Housing Development Fund
Corporation,

Plaintiffs,

-against-

Index No. 601216/06

PAUL LEVIN, JOHN PHILIP HESSLEIN, WINIFRED
VIANI, HUGH VAN DEVENTER, 682 SIXTH
AVENUE, LLC and 682 SIXTH AVENUE HOUSING
DEVELOPMENT FUND CORPORATION,

Defendants.

-----X

DeGrasse, J.:

Plaintiffs move for summary judgment and defendants cross-move for the same relief. 682 Sixth Avenue Housing Development Fund Corporation (the co-op or HDFC) was formed in 1981 pursuant to Business Corporation Law § 402 and Private Housing Finance Law § 573. It operates a housing cooperative in its eight floor building. Ownership in the co-op is divided equally among its seven proprietary lessces who each own one of the co-op’s seven outstanding shares. Its commercial space consists of the ground floor and a portion of the cellar.

In 1996, the co-op leased the commercial space to Greenkay, Inc. for a term which ran from August 7, 1996 through February 28, 2001 with a five year option to renew. At all relevant times, the co-op has been a cooperative housing corporation (CHC) as defined by Internal Revenue Code (26 USC) § 216 (b). “Tenant-stockholders” in a CHC, such as plaintiffs and the

individual defendants, are entitled to income tax deductions for real estate taxes and allowable interest paid or incurred by the CHC during the taxable year (*see* Internal Revenue Code § 216 [a]). To maintain its status as a CHC and enable its shareholders to qualify for the said tax deductions the co-op must derive at least 80% of its gross income from the shareholders (*id.*). This requirement is known as the 80/20 Rule.

It is undisputed that to ensure that the co-op's non-shareholder income remained at less than 20% of its total revenues in compliance with the 80/20 Rule, the co-op's board at its November 6, 2000 meeting, decided to form a limited liability company, such as defendant 682 Sixth Avenue, LLC (the LLC), as a separate entity and lease the commercial space to the LLC at a predetermined rent under a master lease. In turn, the LLC would sublease the commercial space to a third party at a higher rent. Each of the then seven shareholders would receive one of the seven membership units in the LLC. Accordingly, the board voted unanimously to form an LLC for that purpose. As of November 2000, Yael Melamede, Michal Melamede, Jeannette Flax and defendants Paul Levin, John Philip Hesslein, Winifred Viani and Hugh Van Devanter constituted the co-op's board. On or about March 9, 2001, the LLC's articles of organization were filed with the Department of State. The seven shareholders of the co-op received equal membership interests in the LLC.

On February 24, 2001, Hilton Flax and Jeannette Flax contracted to sell their co-op share to plaintiffs Cyrille Allannic and Frederika Buxbaum Allannic. The Allannics understood that the transaction did not include an interest in the LLC.¹ The Allannics further understood that the co-

¹The Flaxes retained their membership interest in the LLC until December 30, 2005 when they sold it to the LLC for \$55,000 less closing costs.

op would lease the commercial space to the LLC which, in turn, would enter into a sublease with a third party. The closing of the contract occurred on May 25, 2001 and Buxbaum Allannic was elected to the co-op board at the June 11, 2001 shareholders' meeting. On the same day, the board elected Levin president and authorized him to sign the master lease with the LLC. The master lease became effective as of March 1, 2001 with an initial term of three years and a five-year renewal option which has since been exercised and approved by the co-op board on August 4, 2003. The master lease provides for a monthly rent of \$1, 550 in 2001 with increases of three percent in 2004 and 2007. In addition, the LLC is required to pay the co-op for real estate tax escalations and other building expenses. Thus, the master lease is set to expire on February 28, 2009. On August 17, 2001, the LLC and Greenkay entered into a sublease for a term which matches that of the master lease. The sublease provides for a 2001 rent of \$9, 500 per month with three percent increases in 2002 and 2003. Pursuant to a modification and extension agreement, the sublease is also set to expire on February 28, 2009. Under the modification, Greenkay pays \$9, 300 a month for the last year of the three year initial term and the first year of the extended term, \$9, 675 per month for the second year of the extended term, \$10, 060 for the third year of the extended term, \$10, 465 for the fourth year of the extended term and \$10, 880 for the last year of the extended term.

On or about March 9, 2005, Michel G. Debiche and Michal Melamede contracted to sell their co-op share to plaintiff Jarrod Fong. Fong understood that the deal did not include the Debiche-Melamede interest in the LLC as the same had been committed to the LLC itself pursuant to a right of first refusal. Fong's closing took place on May 12, 2005. Six days later, the LLC acquired the Debiche-Melamede interest therein for \$65, 000 less closing costs. At the June 6,

2005, shareholders' meeting, Fong was elected and Buxbaum Allannic reelected to the co-op's board. The minutes of the December 6, 2005 co-op board meeting read, in part, as follows:

“LLC lease: [Levin] asked the HDFC to extend the lease to the LLC, which is due to expire in 2009 to 2022. The request was not made in writing. {F. B. ALLANNIC} objected and raised the idea of, for example, leasing to a new LLC in 2009. [Fong] requested the LLC consider making an offer of shares to the two Board members who are not part of the LLC. [Hesslein] protested this request as improper at a co-op meeting. The Board voted to table the discussion to the next meeting.”

Of the seven board members who attended that meeting only Buxbaum Allannic and Fong were not members of the LLC. A vote on the proposed LLC lease extension was taken at the March 13, 2006 co-op board meeting. Levin, Hesslein, Viani and Van Devanter voted in favor of extending the lease to 2022. Fong and Buxbaum Allannic voted against it and nonparty Steven Sparkes abstained. The proposed lease extension calls for the payment of rent in the sum of \$1, 644. 40 per month in 2009 with increases of three percent every three years beginning in 2010 and a monthly rent of \$1, 850. 78 per month in 2022. At a special shareholders' meeting held on November 14, 2006, the proposed master lease extension was ratified by a vote of four to two with one abstention. The individual defendants voted in favor of the measure; plaintiffs voted against it and Sparkes and Yael Melamede jointly abstained. This action was commenced on April 7, 2006.

Plaintiffs allege that the proposed lease extension constitutes a breach of fiduciary duty and is void as a waste and gift of corporate assets. “The essence of a gift is lack of consideration and the essence of waste is the diversion of corporate assets for improper or unnecessary purposes” (*Aranoff v Albanese*, 85 AD2d 3, 5 [1982]). The existence of benefit to the corporation, is generally committed to the sound judgment of the directors (*id.*). The objecting

shareholder has the burden of demonstrating that no person of ordinary sound business judgment would say that the corporation received fair benefit (*id.*). Plaintiffs have not met this burden inasmuch as the proposed lease extension would be nothing more than a continuation of the co-op's practice of utilizing the LLC's master lease as means of assuring the co-op's compliance with the 80/20 Rule and safeguarding the tax benefits enjoyed by the shareholders. Plaintiffs argue in their memorandum of law that "[w]hatever tax benefit the Co-op may gain from entering into an LLC arrangement is beside the point." On the contrary, it is the point. Such use of the master lease was disclosed to plaintiffs when they purchased their respective co-op shares. It was also approved by director Buxbaum Allannic when she voted at the June 11, 2001 co-op board meeting to authorize Levin, the co-op's president, to sign a master lease with a five-year renewal option. Buxbaum Allannic's claim that she did not believe she, as a new board member, was in a position to withhold her approval rings hollow. In their reply memorandum of law plaintiffs argue:

"Today, years later, with the Master Lease that was put in place at that time soon to expire, there is no reason why a new 'rescue entity' could not be created to do today what was done in 2000 and 2001 and allow *all* the current co-op shareholders to share in the benefits of the Commercial Space *and* the 80/20 Rule."

This argument and the minutes of the December 6, 2005 board meeting reveal that plaintiff's grievance does not really concern the extension of the master lease. Instead it concerns the fact that plaintiffs are not members of the LLC, a separate entity.

Plaintiffs cite *Schwartz v Marien* (37 NY2d 487, 491 [1975]) for the proposition that members of a corporate board of directors owe a fiduciary responsibility to the shareholders in general and to individual shareholders in particular to treat all shareholders fairly and evenly.

Schwartz involves the sale of a closely corporation's treasury stock to its directors and the resultant disturbance of the equality of its stock ownership. The instant case is distinguishable because it involves the extension of a master lease which had been in place for five years before plaintiffs voiced their objection to the proposed extension. The *Schwartz* Court also held that departure from precisely uniform treatment of stockholders may be justified where a bona fide business purpose indicates that the best interests of the corporation would be served by such departure (*id.* at 492). Accordingly, even if the proposed master lease extension would treat shareholders unequally' 80/20 compliance would constitute the required bona fide business purpose. For the foregoing reasons, plaintiffs' motion is denied and defendants' cross motions granted. It is adjudged and declared that the co-op board's March 13, 2006 vote to extend the master lease is valid. In all other respects, the complaint is dismissed. Settle judgment and order.

Dated: January 4, 2008



J. S. C.

HON. LELAND DeGRASSE