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REAL ESTATE LAW ALERT

CO-OP AND CONDO BUILDINGS SUBJECT TO HEIGHTENED DISCLOSURE AND ANNUAL REPORTING REQUIREMENTS FOR RELATED PARTY TRANSACTIONS

Key Points

On September 12, 2017, Governor Andrew Cuomo signed legislation, effective January 1, 2018, amending New York's Business Corporation Law (BCL) and Not-For-Profit Corporation Law (NFPC) which compel cooperative corporations and condominiums organized under these statutes to produce annual reports detailing all contracts involving any interested directors. The new law also requires that co-ops and condos submit an annual report to shareholders or unit owners regarding any such related-party contracts.

While these new requirements will be of general interest to individual unit owners, property managers and sponsors of new developments and conversions should be particularly aware of this law, since sponsors often enter into transactions with related parties (especially for property management and related services) even before the building's development or conversion is complete.

Behind the Scenes

Current law provides that if a corporate director (a concept which is generally deemed to include members of condo boards) has a "substantial financial interest" in a transaction, either directly or through an entity, then this interest must be disclosed to the board in good faith, and the transaction must be approved by the board without the interested director's vote, or by the shareholders or unit owners directly. Under current law, shareholders were unlikely to be aware of these potential conflicts of interest.

While the New York State Assembly Memorandum in Support of Legislation highlights the purpose of this law as ensuring that directors understand the law with respect to related-party transactions, the other justification set forth in the Memorandum is ensuring that shareholders or unit owners are notified of related-party contracts. The board will now be required to distribute an annual report to shareholders specifying the details of all such contracts entered into by the board.

Requirements

The law requires that the board's annual reports must include the following information with respect to each related-party contract:

- The identities of the contracting parties, the dates that the contract is effective, the contract amount, and the purpose of the contract; and
- Records of each board meeting where a related-party contract was approved, showing the meeting date, which board members attended, and how each board member voted on each related-party contract.

The report must be signed by every member of the board.

The board must still prepare and distribute a signed report even if there were no related-party transactions, confirming that no actions were taken by the board that triggered the reporting requirement.

Each board member must be provided with a copy of the statutory provisions which cover interested-director transactions (BCL Section 713 or NFPCL Section 715, as applicable).

More Changes to Come?

The new law only affects boards formed pursuant to the BCL or the NFPCL. As most condominiums are unincorporated associations formed under the Condominium Act (Article 9-B of the Real Property Law), we expect that a technical amendment will be adopted clarifying that all condominiums are covered by these new requirements.

Importantly, the new legislation is silent on enforcement and oversight. Currently, the only available remedy for potential violations may be civil litigation brought by aggrieved owners or board members. Ultimately, future amendments may also address enforcement of these new requirements.

Best Practices

We recommend that cooperative corporations and condominiums consider amending their governing documents to ensure ongoing compliance with the new legislation. Specifically, boards should establish procedures for tracking related-party contracts and annual report distribution.

We are available to provide counsel and guidance concerning the most efficient and cost-effective means to comply with this new law, as well as other cooperative and condominium law and general real estate law issues. For additional information, please contact one of the attorneys named below or your primary Phillips Nizer attorney.

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