BUSINESS ASSOCIATIONS

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INTRODUCTION

In this *Survey* period, there was no legislation amending the business associations statutes, but the Legislature, in amending the not-for-profit corporation law, enacted a statutory interpretation of a basic principle in business associations law. In particular, the Legislature adopted statutory definitions specifying when a transaction, in which a director or officer of a not-for-profit corporation has an interest, needs to be disclosed to disinterested directors and approved by them.[1]

In decisional law, New York courts continued to provide insight

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1. See Act of December 18, 2013, ch. 549, McKinney's 2013 Sess. Laws of N.Y. (codified at N.Y. NOT-FOR-PROFIT-CORP. LAW §§ 102, 713, 715 (McKinney 2014)).

and direction as to the principles of business associations, and, as in the case of *Geron v. Robinson & Cole LLP (In re Thelen LLP)*[2] discussed below, issues were framed and moved forward for resolution. Limited liability companies ("LLCs") continued to look more and more like corporations in case law involving organization by estoppel and fiduciary duties.

I. LEGISLATIVE DEVELOPMENTS

During the *Survey* period, the New York State Legislature passed the Nonprofit Revitalization Act of 2013 ("Act").[3] In addition to the Act's importance for New York not-for-profit corporations, the Act adopted definitions that give more specificity to the concept of interested party transactions.[4] Section 74 of the Act amends section 715 of the Not-for-Profit Corporation Law[5] regarding transactions between the corporation and interested directors and officers.

The text of section 715(a), before amendment, read:

> (a) No contract or other transaction between a corporation and one or more of its directors or officers, or between a corporation and any other corporation, firm, association or other entity in which one or more of its directors or officers are directors or officers, or have a substantial financial interest, shall be either void or voidable for this reason alone or by reason alone that such director or directors or officer or officers are present at the meeting of the board, or of a committee thereof, which authorizes such contract or transaction, or that his or their votes are counted for such purpose:
>
> (1) If the material facts as to such director's or officer's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the board or committee, and the board or committee authorizes such contract or transaction by a vote sufficient for such purpose without counting the vote or votes of such interested director or officer; or
>
> (2) If the material facts as to such director's or officer's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the members entitled to vote thereon, if any, and such contract or transaction is authorized by vote of such members.[6]

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2. 476 B.R. 732 (S.D.N.Y. 2012).
3. § 1 of Act of December 18, 2013.
4. *Id*.
5. *Id.* at § 74 (codified at N.Y. NOT-FOR-PROFIT CORP. LAW § 715).
6. N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a).

Former section 715(a) closely tracked the text of section 713(a) of the business corporation law,[7] which also uses the words "substantial financial interest" and "material facts" to determine whether a director has a conflict of interest and whether adequate disclosure has been made to the full board.[8] The authors note that section 411(a) of the LLC Law[9] applies the same tests to managers of an LLC.

The Act focuses on a "related party transaction" and requires disclosure in new section 715(a):[10]

> (a) No corporation shall enter into any related party transaction unless the transaction is determined by the board to be fair, reasonable and in the corporation's best interest at the time of such determination. Any director, officer or key employee who has an interest in a related party transaction shall disclose in good faith to the board, or an authorized committee thereof, the material facts concerning such interest.[11]

The Act adds definitions to section 102(a) of the not-for-profit corporation law[12] for "relative," "related party," "related party transaction" and "key employee," as follows:

> (22) "Relative" of an individual means his or her (i) spouse, ancestors, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great-grandchildren, and spouses of brothers, sisters, children, grandchildren, and great-grandchildren; or (ii) domestic partner as defined in section twenty-nine hundred ninety-four-a of the public health law.
>
> (23) "Related party" means (i) any director, officer or key employee of the corporation or any affiliate of the corporation; (ii) any relative of any director, officer or key employee of the corporation or any affiliate of the corporation; or (iii) any entity in which any individual described in clauses (i) and (ii) of this subparagraph has a thirty-five percent or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of five percent.
>
> (24) "Related party transaction" means any transaction, agreement or any other arrangement in which a related party has a financial interest and in which the corporation or any affiliate of the corporation is a

7. N.Y. Bus. Corp. Law § 713(a) (McKinney 2014).

8. *Id.* at § 713(a)(1)-(2).

9. N.Y. Ltd. Liab. Co. Law § 411(a) (McKinney 2014).

10. § 74 of Act of December 18, 2013 (codified at N.Y. Not-for-Profit Corp. Law § 715(a)).

11. N.Y. Not-for-Profit Corp. Law § 715(a).

12. § 29 of Act of December 18, 2013 (codified at N.Y. Not-for-Profit Corp. Law § 102).

participant.

(25) "Key employee" means any person who is in a position to exercise substantial influence over the affairs of the corporation, as referenced in 26 U.S.C. § 4958(f)(1)(A) and further specified in 26 CFR § 53.4958-3(c), (d) and (e), or succeeding provisions.[13]

These definitions add clarity, but may come at a cost compared to the usefulness of the "have a substantial financial interest" standard in previous section 715(a)(1). The new term, "financial interest" in new section 102(a)(24),[14] replaces "substantial financial interest," indicating that the Legislature intended to cover financial interests regardless of amount. The former "substantial financial interest" standard extended into any relationship that might give the director or officer an "interest."[15] Under the new section 715(a), the express requirement for disclosure and approval by a disinterested board applies only to a "related party transaction."[16] Thus, not all persons with whom a director or officer might have had an interest under the previous standard are now necessarily covered.

A literal application of the new definitions could produce odd results. For example, under the not-for-profit corporation law as amended by the Act, if a newspaper publisher is on the board of directors of a not-for-profit corporation, and the corporation desires to purchase a subscription to that publisher's newspaper, new section 715(a) of the Act will require approval by a fully-informed and disinterested board. On the other hand, a mother-in-law or father-in-law is not a "relative" within the meaning of new section 102(a)(22).[17] Consequently, if the chief executive officer of the corporation desires to sell all of its assets to that officer's father-in-law, new section 715(a) will not require approval by the board. The authors hope that, in such a case, safeguards elsewhere in the not-for-profit corporation law will be adequate to protect the corporation.

Section 74 of the Act[18] opens avenues of speculation, because the Legislature did not specify whether it intended merely to codify common law or change it. As a result, we must wait to see how the courts will use the new definitions in the Act to interpret the terms

13. *Id.* at § 29 (codified at N.Y. NOT-FOR-PROFIT CORP. LAW § 102(22)-(25)).

14. N.Y. NOT-FOR-PROFIT CORP. LAW § 102(24).

15. The "have a substantial financial interest" standard still applies in the Business Corporation Law and Limited Liability Company Law. *See* N.Y. BUS. CORP. LAW § 713(a); N.Y. LTD. LIAB. CO. LAW § 411(a).

16. N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a).

17. N.Y. NOT-FOR-PROFIT CORP. LAW § 102(a)(22) (McKinney's 2013).

18. N.Y. NOT-FOR-PROFIT CORP. LAW § 74 (McKinney's 2013).

"substantial financial interest" and "material facts" in section 713 of the business corporation law. Notably, the New York State Assembly Memorandum in Support of Legislation contains discussion of other sections of the Act, but not section 74.

The Act was signed into law by the Governor on December 18, 2013 and became effective on July 1, 2014. It may be worth noting that the Governor's Approval Memorandum states, "[t]he bill as passed contains certain technical defects and barriers to implementation. The Legislature has agreed to remedy these deficiencies by passing additional legislation. On that basis, I am signing this bill."[20]

II. PARTNERSHIPS

A. Unfinished Business

During the Survey period, opposing sides on the problem of "unfinished business" were better delineated. The U.S. District Court for the Southern District of New York, in *Geron v. Robinson & Cole LLP (In re Thelen LLP)*[21] ("*Thelen*"), held that, under New York law, "a law firm's pending hourly fee matters are not partnership assets."[22] This holding expressly disagreed with *Development Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP (In re Coudert Brothers LLP)*[23] ("*Coudert*"), an opinion delivered not more than four months earlier by a different U.S. District Judge also in the Southern District of New York. *Coudert* held that pending hourly fee matters were partnership assets, as to which former partners of a dissolved law firm are required to account.[24]

In *Thelen*, the unfinished business issue arose out of the dissolution of the law firm, Thelen LLP, followed by a petition in the U.S. Bankruptcy Court for the Southern District of New York for relief under the Bankruptcy Code.[25] The *Thelen* bankruptcy trustee brought claims against two of the new law firms to which former Thelen partners had moved, "to recover profits from work that former Thelen partners

20. 2013 N.Y. Sess. Laws 1545 (McKinney 2013).

21. 476 B.R. 732 (S.D.N.Y. 2012).

22. *Id.* at 743.

23. 477 B.R. 318 (S.D.N.Y., May 24, 2012). The opinion was discussed in last year's survey, Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2011-2012 Survey of New York Law*, 63 SYRACUSE L. REV. 560, 577-83 (2013). The court issued an amended decision on July 18, 2012, with changes not relevant to this discussion, at 480 B.R. 145 (S.D.N.Y., July 18, 2012). In this discussion of *Thelen*, the amended decision is cited and referred to as "*Coudert*."

24. *Coudert,* 480 B.R. at 154.

25. *Thelen,* 476 B.R. at 736.

performed *after* they joined those two law firms."[26] The bankruptcy trustee invoked the "unfinished business doctrine," described as:

> "[t]he general rule that the business of a partnership that is unfinished on the date the partnership dissolves is an asset of the partnership, and must be concluded for the benefit of the dissolved partnership."[27]

The leading case applying the unfinished business doctrine to a dissolved law firm's legal matters was the 1984 California decision in *Jewel v. Boxer*.[28] In *Jewel*, former partners of a dissolved legal partnership were obligated to account to the dissolved partnership for net post-dissolution income from unfinished legal matters.[29] *Jewel* did not discuss whether legal matters billed on an hourly basis should be treated differently than other legal matters.

In *Thelen*, at the time of dissolution, the partners of the failing law firm had added a "Jewel Waiver" to the partnership agreement, providing that the former partners and the dissolved partnership would have no rights in "unfinished business."[30] After Thelen filed for bankruptcy, the bankruptcy trustee asserted that Thelen's Jewel Waiver constituted a fraudulent transfer of Thelen property.[31]

After deciding that New York law applied to the question of whether unfinished business was Thelen's "property,"[32] the *Thelen* court distinguished between contingent fee cases, where New York law considered them to be partnership assets,[33] and hourly-rate cases, where the only New York state court to consider them, *Sheresky v. Sheresky Aronson Mayefsky & Sloan, LLP,*[34] had decided that they were not partnership assets.[35] According to the U.S. District Court in *Thelen,* "[a]lthough Sheresky is not binding authority, a New York trial court's interpretation of New York law is entitled to 'great weight.'"[36] The *Thelen* court presented two arguments from *Sheresky* against treating

26. *Id.* (emphasis added).

27. *Id.* at 739 (quoting Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP (the first version of the *Coudert* opinion), 477 B.R. 318, 332 (S.D.N.Y. May 24, 2012) (citing Stem v. Warren, 227 N.Y. 538, 125 N.E. 811 (1920))).

28. 203 Cal. Rptr. 13 (Cal. Ct. App. 1984).

29. *Id.* at 19.

30. *Thelen*, 476 B.R. at 736.

31. *Id.* at 736-37.

32. *Id.* at 737-38.

33. *Id.* at 739 (citing Santalucia v. Sebright Transp., Inc., 232 F.3d 293, 297 (2d Cir. 2000)).

34. 2011 N.Y. Slip Op 52504(U) (Supreme Ct., N.Y. Cnty. 2011).

35. *Id.* at *7.

36. *Thelen*, 476 B.R. at 740 (quoting In re Brooklyn Navy Yard Asbestos Litig., 971 F.2d 831, 850 (2d Cir. 1992)).

hourly-rate cases as partnership assets.[37] First,

> [u]nlike in the contingency fee context, applying the unfinished business doctrine to pending hourly fee matters would result in an unjust windfall for the Thelen estate, as "compensating a former partner out of that fee would reduce the compensation of the attorneys performing the work." Such an expansion of the doctrine would violate New York's public policy against restrictions on the practice of law.[38]

Second, if the lawyer must account after dissolution to the former law firm for some of the profit to be made from post-dissolution work on a matter, then payments by the client for the matter would be split impermissibly between the current lawyer and the former law firm in violation of New York Rules of Professional Conduct.[39]

A further argument in *Thelen* was that, in the case of contingent-fee cases, New York precedents allowed the departing partner to keep that portion of fees "due to a surviving partner's post-dissolution efforts, skill and diligence."[40] Where an hourly-rate matter is billed regularly, the dissolved law firm is normally paid for work performed before dissolution, whereas post-dissolution legal fees are generated by hours worked by the successor lawyer or law firm. The *Thelen* court thus reasoned that all post-dissolution fees generated on an hourly matter should be attributable to "post-dissolution efforts, skill and diligence," and logically none attributed to the dissolved partnership.[41]

Despite its elegance, this logic had been rejected in *Stem v. Warren,*[42] a 1920 Court of Appeals case on unfinished business. *Stem* recognized that a post-dissolution contract between an architectural partnership and its client, though terminable by either side at will at any time, was nevertheless a valuable asset of the partnership; and the partner who assumed the contract post-dissolution was still required to account to former partners for any profits generated from that contract.[43]

The *Coudert* court characterized the monthly-billing argument as

37. *Id.* at 740.

38. *Id.* (citing *Sheresky,* 2011 N.Y. Slip Op 52504(U) at *6; Cohen v. Lord, Day & Lord, 75 N.Y.2d 95, 96, 550 N.E.2d 410, 551 N.Y.S.2d 157 (1989)).

39. *Id.* at 740. In *Sheresky,* 2011 N.Y. Slip Op 52504(U), the argument was made at *6, citing Disciplinary Rule 1.5(g), 22 N.Y. COMP. CODES R. & REGS. tit. 22, § 1200.0, Rule 1.5(g).

40. *Thelen*, 476 B.R. at 740 (citing Santalucia v. Sebright Transp., Inc., 232 F.3d 293, 298 (2d Cir. 2000)).

41. *Id.* at 741.

42. 227 N.Y. 538, 125 N.E. 811 (1920).

43. *Id.* at 547, 125 N.E. at 813.

follows:

> [A]n engagement to represent a client in a matter—to defend a corporation in a shareholder suit, say, or to prepare documents and provide tax advice in connection with some corporate transaction—does not give rise to a single contract, but rather a series of "mini-contracts," each one corresponding to a new billing period. "Unfinished business," . . . effectively becomes "finished business" with the submission of each periodic invoice. . . . [I]f it were the practice of a law firm to bill its clients on the first day of every month, then when the firm dissolved on May 15 (1) all work done prior to the issuance of the May 1 invoice would be "finished business;" (2) work performed in May but not yet billed would be "unfinished business" (and so subject to the unfinished business rule); while (3) work performed elsewhere by former members of the dissolved firm, during what would have been subsequent billings periods (June, July, August), would be "new business," and so would not subject the former partners to any duty to account. [44]

Coudert rejected this argument and held that

> [this] argument conflates a law firm's rights against its clients—which may differ according to how the matters is billed—and the rights of former partners among themselves, including the right to demand an accounting from any partner who derives a benefit from exploiting a partnership asset.[45]

To rephrase the court's view in *Coudert*, following *Stem*, a partner is required to account to the previous partnership for any profits derived by that partner from an hourly matter taken to the new firm. The rationale is not to make sure the previous partnership was paid for its work – that presumably happens when the clients pay the invoices of the previous partnership – but under an obligation of fairness that former partners owe to each other.[46]

Thelen sought to distinguish *Stem*, "a hoary case involving architecture partnerships,"[47] from the *Thelen* bankruptcy case, ultimately relying on the attorney-client relationship:

> [C]ontracts for legal services are categorically different from architecture contracts. Clients repose ultimate trust and confidence in their attorneys. The attorney's obligations, therefore, transcend those prevailing in the commercial market place, and the contract under which an attorney is employed by a client has peculiar and distinctive

44. *Coudert*, 480 B.R. at 166.
45. *Id.*
46. *Id.*
47. *Thelen,* 476 B.R. at 741.

> features. (internal quotation marks and citations omitted)
>
> A pending client matter is not an ordinary article of commerce. Contrary to [*Coudert*], an hourly fee matter is not akin to "a Jackson Pollack [sic] painting" that a departing attorney "rip[s] off the wall of the reception area[.]" [*Coudert*, 480 B.R. at 157]. The client, not the attorney, moves a matter to a new firm. Thus, the attorney-client relationship is unique, and applying *Stem* to hourly fee legal service contracts would undermine it. New York law does not countenance such a result. Clients are not merchandise. Lawyers are not tradesmen. An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status." [quoting *Cohen v. Lord, Day & Lord,* 75 N.Y.2d 95 at 98, 550 N.E.2d 410, 551 N.Y.S.2d 157 (1989), which was quoting in turn from Opinion 109 of the New York County Lawyers' Association issued in 1943]. This policy applies just as forcefully to client matters.[48]

The importance of this distinction between lawyers and "tradesmen" arises from the need, or at least the desire, of the client to continue with the lawyer of his or her choice. A partner from a dissolved law partnership might easily find that a successor law firm prefers to decline taking on the lawyer's hourly matters, because it does not wish to be involved in an accounting proceeding with a dissolved law partnership. Another result could be that old matters from the dissolved law firm might be subject to a significant discount, as compared to the partner's new business. *Thelen*'s concern then seems to be the potential harm to the *client,* who might be forced to change lawyers, regardless of the client's preference, not because of any harm to the lawyer. Based on "New York's strong public policy in favor of client autonomy and attorney mobility[,]"[49] *Thelen* held that pending hourly-rate legal matters are not property of a dissolved law firm.[50]

Thelen also raised the issue of "bizarre consequences"[51] possible under the federal Bankruptcy Code by treating hourly-rate matters as partnership property. Under section 363 of the Bankruptcy Code,[52] the bankruptcy trustee has authority to sell property of the debtor to the highest bidder,[53] but selling off an hourly matter "is inconsistent with a

48. *Id.* at 742.

49. *Id.* at 742-43 (citing Cohen v. Lord, Day & Lord, 75 N.Y.2d 95, 98, 550 N.E.2d 410, 551 N.Y.S.2d 157 (1989); Denburg v. Parker Chapin Flattau & Klimpl, 82 N.Y.2d 375, 381-82, 624 N.E.2d 995, 604 N.Y.S.2d 900 (1993)).

50. *Id.* at 743.

51. *Id.* at 741.

52. 11 U.S.C. § 363 (2013).

53. *Thelen*, 476 B.R. at 741.

client's right to choose attorneys."[54] Further, if an hourly-rate client did not follow the departing partner but chose instead a law firm having no partners from the old law firm, the client might have exercised control over property of the bankruptcy estate, in violation of the automatic stay.[55] *Thelen* concluded that "[t]hese unworkable results militate powerfully against extending the unfinished business doctrine to hourly fee matters."[56]

Hence, we have the anomaly of two U.S. District Court opinions arriving squarely on opposite sides of the question. *Coudert* emphasized the usefulness of the unfinished business rule in *Stem* as the default rule for partnerships in general, observing that the rule could be reversed in a partnership agreement.[57] *Thelen*, on the other hand, considered the undermining consequences to the attorney-client relationship should the default rule be extended to law partnerships.[58]

After the Survey Period, on appeal, the Second Circuit certified the "unfinished business" issue for review to the New York Court of Appeals.[59] The Court of Appeals accepted and resolved the issue by holding, for reasons similar to *Thelen*, that an attorney's hourly-rate matters should not constitute partnership property and therefore should not be subject to an accounting.[60]

B. Valuation.

Section 69(2)(c)(II) of the New York Partnership Law provides, in general, that when a partner in a partnership causes the partnership to be dissolved in contravention of the partnership agreement, then, if the business is continued in the same name by all of the non-breaching partners, the breaching partner has the right "to have the value of his interest in the partnership, less any damages caused to his copartners by the dissolution, ascertained and paid to him in cash . . . but in ascertaining the value of the partner's interest the value of the good-will of the business shall not be considered."[61]

54. *Id.* (citing Demov, Morris, Levin & Shein v. Glantz*,* 53 N.Y.2d 553, 556, 428 N.E.2d 387, 444 N.Y.S.2d 55 (1981)).

55. *Id.* at 741 (citing 11 U.S.C. § 362).

56. *Id.* at 741. The opinion does not describe why the unworkable results do not also militate against the unfinished business doctrine applied to contingent fee matters.

57. Dev. Specialists, Inc. v. Akin Gump Strauss Hauer & Feld LLP, 480 B.R. 145, 159 (S.D.N.Y. July 18, 2012).

58. *Thelen*, 476 B.R. at 742.

59. Geron v. Seyfarth Shaw LLP (In Re Thelen LLP), 736 F.3d 213 (2d Cir. 2013).

60. In re Thelen LLP, 2014 N.Y. LEXIS 1577.,

61. N.Y. P'SHIP LAW § 69(2)(c)(II) (McKinney 2014).

Quick v. Quick[62] considered how to value such an interest. The trial court calculated the value by adding up the fair market values of assets in accordance with their asset classes,[63] apparently so that the value of the goodwill could be excluded in accordance with section 69(2). The continuing partner wanted the business' gold inventory to be valued at its historical cost (that is book value), while the trial court held that the gold inventory should be valued at its higher fair market value.[64]

The continuing partner similarly wanted the partnership's machinery and equipment valued at their stated book value of $37,311; but the trial court added $700,000 to reflect fair market value.[65] The Second Department affirmed the use of fair market value, rather than book value,[66] but held that the total amount of $737,311, as calculated by the trial court, had not been properly determined because the lower court "should not have substituted its own determination for that of the parties' experts."[67] The Second Department adopted $299,300, the fair market value presented at trial by the plaintiff's expert, because

> the plaintiff's expert, unlike the defendants' expert, appropriately took into consideration such factors as the age of the subject equipment, the niche market served by the partnership's business, and the uncertainty of the business's continued tenancy at its location at the time of dissolution. In addition, the plaintiff's expert took into account the income stream of the business before arriving at a valuation method, and the fact that some equipment had been cannibalized for parts. Furthermore, unlike the defendants' expert, the plaintiff's expert had documentation to support all of his calculations.[68]

Quick v. Quick provides useful case law authority supporting use of these common-sense elements to calculate fair market value.

III. LIMITED LIABILITY COMPANIES

A. Entity doctrines applicable to limited liability companies.

1. Organization by Estoppel.

The doctrine of incorporation by estoppel was extended to LLCs in

62. 100 A.D.3d 611, 953 N.Y.S.2d 271 (2d Dep't 2012).
63. *Id.* at 612-13, 953 N.Y.S.2d at 273.
64. *Id.* at 612, 953 N.Y.S.2d at 272.
65. *Id.*
66. *Id.*
67. *Quick*, 100 A.D.3d at 612, 953 N.Y.S.2d at 272.
68. *Id.*

JCL Properties, LLC v. Equity Land Developers, LLC.[69] The plaintiff, JCL Properties, LLC, allegedly performed under a contract to obtain a real estate mortgage loan commitment for defendant, and when defendant did not pay plaintiff the agreed-upon fee, plaintiff sued.[70] Defendant moved to dismiss on the grounds that (1) the plaintiff was not yet organized at the time the contract was allegedly entered into;[71] and (2) that plaintiff was not a licensed real estate broker.[72]

The court applied the "incorporation by estoppel" doctrine[73] to prevent "defendant from using the plaintiff's lack of incorporation as a sword to escape liability after it allegedly benefitted from its agreements with the plaintiff."[74] Defendant's second defense, however, was successful because the plaintiff LLC was not a licensed real estate broker at the relevant time (although the plaintiff's principal was licensed).[75]

2. No Merger with an Individual.

Hamilton Equity Group, LLC v. Juan E. Irene, PLLC[76] involved an unusual argument by a plaintiff creditor that a sole proprietorship had succeeded to the liabilities of a defendant LLC by a de facto merger.

The plaintiff was owed a balance on a line of credit by defendant Juan E. Irene, PLLC, a New York professional service limited liability company (the "PSLLC").[77] Plaintiff had a security interest in the PSLLC's assets, but did not have a personal guaranty from the individual defendant, Juan Irene.[78] Articles of dissolution were filed

69. 102 A.D.3d 745, 958 N.Y.S.2d 433 (2d Dep't 2013).

70. *Id.* at 745, 958 N.Y.S.2d at 433-34.

71. *Id.* at 745, 958 N.Y.S.2d at 434. The plaintiff, a limited liability company, would not have assumed legal existence until "the time of the filing of the initial articles of organization with the department of state or at any later time specified in the articles of organization, not to exceed sixty days from the date of such filing." N.Y. LTD. LIAB. CO. LAW § 203(d) (McKinney 2014).

72. *JCL Props. LLC*, 102 A.D.3d at 746, 958 N.Y.S.2d at 434.

73. *Id.*

74. *Id.* (citing Boslow Family Ltd. Partnership v. Glickenhaus & Co., 7 N.Y.3d 664, 668, 860 N.E.2d 711, 713, 827 N.Y.S.2d 94, 96 (2006) ("Defendant is estopped from contending that plaintiff was not a limited partnership because defendant is using that sword to escape liability after it benefitted from its contract with plaintiff."); Rubenstein v. Mayor, 41 A.D.3d 826 at 828-829, 839 N.Y.S.2d 170, 172 (2d Dep't 2007) (corporation made contract one day before its certificate of incorporation was filed, but persons engaged in business dealings with the corporation could not later deny the corporation's status)).

75. *Id.* (citing N.Y. REAL PROP. LAW § 442-d (McKinney 2012)).

76. 101 A.D.3d 1703, 957 N.Y.S.2d 527 (4th Dep't 2012).

77. *Id.* at 1703, 957 N.Y.S.2d at 528.

78. *Id.* at 1703-04, 957 N.Y.S.2d at 528-29.

with the New York Department of State to dissolve the PSLLC.[79] Thereafter, the individual defendant practiced law as a sole proprietor[80] under the name "The Law Office of Juan Irene, Esq.," and continued to handle cases previously handled by the PSLLC.[81] The Fourth Department's opinion noted that "[p]ersonal injury cases previously handled by the PSLLC were transferred to [individual] defendant's law practice, and defendant does not dispute that plaintiff has a security interest in a portion of the attorney's fees that may be generated by those personal injury cases."[82] Thus, fraudulent conveyance does not appear to have been at issue.

At issue, rather, was the trial court's determination that the individual defendant was liable for the PSLLC's debt because the individual was the "successor by merger" to the PSLLC.[83] The Fourth Department noted that the de facto merger doctrine "creates an exception to the general principle that an acquiring corporation does not become responsible thereby for the [preexisting] liabilities of the acquired corporation."[84] The doctrine "was originally developed to protect, inter alia, shareholder rights, but it has been applied in products liability and breach of contract actions."[85]

Next, the Appellate Division construed the LLC Law. Because the PSLLC was created under article 12 of the New York LLC Law,[86] merger was governed by that article.[87] Sections 1213 and 1216[88] allow merger of a professional service LLC with an "other business entity" if specified criteria are satisfied,[89] but "other business entity" is defined in section 102(v) of the LLC Law as "any person *other than a natural person* or domestic limited liability company" (emphasis added by the court).[90] The court held that, therefore, the LLC Law "specifically

79. *Id.* at 1704, 957 N.Y.S.2d at 529.

80. *Id.* at 1705, 957 N.Y.S.2d at 530.

81. *Hamilton Equity Grp., LLC*, 101 A.D.3d at 1704, 957 N.Y.S.2d at 529.

82. *Id.*, 957 N.Y.S.2d at 529.

83. *Id.*

84. *Id.* at 1704-05, 957 N.Y.S.2d at 529 (quoting Simpson v. Ithaca Gun Co., LLC, 50 A.D.3d 1475, 1476, 856 N.Y.S.2d 397 (2008) (internal quotation marks omitted)).

85. *Id.* at 1704, 957 N.Y.S.2d at 529, (citing Sweatland v. Park Corp., 181 A.D.2d 243, 246, 587 N.Y.S.2d 54 (1992); Schumacher v Richards Shear Co., 59 N.Y.2d 239, 244-245, 451 N.E.2d 195, 464 N.Y.S.2d 437 (1983); Washington Mut. Bank, F.A. v SIB Mtge. Corp., 21 A.D.3d 953, 954, 801 N.Y.S.2d 821 (2005); Ladenburg Thalmann & Co. v. Tim's Amusements, 275 A.D.2d 243, 247-248, 712 N.Y.S.2d 526 (2000)).

86. N.Y. LTD. LIAB. CO. LAW, § 1216 (McKinney 2014).

87. *Hamilton,* 101 A.D.3d at 1705, 957 N.Y.S.2d at 529.

88. N.Y. LTD. LIAB. CO. LAW §§ 1213 and 1216 (McKinney 2014).

89. *Hamilton,* 101 A.D.3d at 1705, 957 N.Y.S.2d at 529-30.

90. *Id.* at 1705, 957 N.Y.S.2d at 530, (citing N.Y. LTD. LIAB. CO. LAW § 102(v)

excludes a professional service limited liability company from being merged or consolidated with a 'natural person[.]'"[91] A sole proprietorship was the same as a "natural person" for this purpose.[92] The court noted similar language in section 901 of the New York Business Corporation Law[93] and concluded that "under New York law, neither a professional limited liability company nor a corporation is permitted by statute to merge with a 'natural person,' individual or 'sole proprietorship.'"[94]

The conclusion seems fair. On the one hand, the defendant simply changed his business entity from a PSLLC to a sole proprietorship; on the other hand, the plaintiff was the successor in interest to a bank which had voluntarily made a loan to a limited liability entity without obtaining a personal guaranty.[95] In addition, the plaintiff had a security interest in substantially all of the PSLLC's assets which continued after the PSLLC dissolved.[96] Accordingly, the defendant had not worsened the position of the plaintiff as a secured creditor.

B. Fiduciary Duty of Promoters

In *Roni LLC v. Arfa*,[97] plaintiffs alleged that "the promoter defendants deliberately concealed that the property sellers and mortgage brokers paid them commissions of up to 15% of the purchase prices of the properties and that these commissions inflated the purchase prices by millions of dollars."[98] The First Department held that LLC promoters, as such, have a fiduciary duty to investors to make full disclosure of their profits from organizing the LLC,[99] and that plaintiffs had not established a second ground of fiduciary duty based upon the business or personal relationship between the defendants and the plaintiffs.[100] Although the Court of Appeals affirmed,[101] it came to a

(McKinney 2014)).

91. *Id.* at 1705, 957 N.Y.S.2d at 530.

92. *Id.*

93. N.Y. BUS. CORP. CO. LAW § 901(b)(7) (McKinney's 1999).

94. *Hamilton,* 101 A.D.3d at 1706, 957 N.Y.S.2d at 530.

95. *Id.* at 1703-04, 957 N.Y.S.2d at 528-29.

96. *Id.* at 1704, 957 N.Y.S.2d at 529.

97. 74 A.D.3d 442, 903 N.Y.S.2d 352 (1st Dep't 2010), *affirmed,* 18 N.Y.3d 846, 963 N.E.2d 123, 939 N.Y.S.2d 746 (2011).

98. *Id*. at 443, 903 N.Y.S.2d 354.

99. *Id.* at 444-45, 903 N.Y.S.2d at 355.

100. *Id.* at 444, 903 N.Y.S.2d at 355 (citations omitted).

101. Roni LLC v. Arfa, 18 N.Y.3d 846, 847, 963 N.E.2d 123, 124, 939 N.Y.S.2d 746, 747 (2011). The opinion was discussed in last year's survey, Sandra S. O'Loughlin & Christopher J. Bonner, *Business Associations, 2011-2012 Survey of New York Law*, 63

different conclusion regarding the two sources of fiduciary duty, and determined that the allegations that defendants had played upon plaintiffs' ignorance, trust, and confidence were sufficient to plead a violation of fiduciary duty.[102] The Court left open the question of "whether the promoter defendants' status as organizers of the limited liability companies, standing alone, was sufficient[.]"[103]

On remand, the trial court in *Roni LLC v. Arfa* granted summary judgment against the promoters because they did not disclose their payments from the sellers.[105] The trial court held that the decisions of the appellate division and the Court of Appeals "each articulate[s] a standard upon which . . . [p]laintiffs may establish that the [p]romoters owed them a fiduciary duty, either as promoters of the [p]roperty LLCs [appellate division] or as a result of their superior experience and expertise [Court of Appeals]."[106] The trial court held that the defendants owed the investors a fiduciary duty because they were LLC promoters,[107] and concluded that it did not need to determine whether the defendants' "superior experience and expertise" created a fiduciary duty.[108]

Interestingly, the promoters argued that in some of the LLC operating agreements, they *had* disclosed the fact that they might be taking payments from the property sellers.[109] The specific language in the agreements was that the promoters

> "may engage in other activities in addition to those relating to the [Property LLC], including, without limitation, providing services to the seller of the Property and/or its principals or affiliates" and that "the [Promoters] and any of their affiliates can provide services to the [Property LLC] and collect fees or other payments, including, without limitation, acting as broker, agent, or otherwise, or based on transactions where the fee has been disclosed to the [Plaintiffs] or taken into consideration in projections, pro forma statements or otherwise in writing[.]"[110]

But, the court said those agreements

SYRACUSE L. REV. 560, 569-71 (2013).

102. *Id.*

103. *Id.* at 849, 963 N.E.2d at 125, 939 N.Y.S.2d at 748.

105. No. 601224/07, 2013 N.Y. Slip Op. 31424(U) (Sup. Ct. N.Y. Cnty. 2013).
at *17-18.

106. *Id.* at *8.

107. *Id.* at *14.

108. *Id.* at *14-15.

109. *Id.* at *15.

110. *Id.* at *15-16 (quotation marks and internal bracketing by court).

> fail to specify the amount of the Commissions that will be taken by [the LLCs' broker], the method for determining the amount of Commissions for each transaction, and that the Commissions were being paid by the sellers of the Properties. The purported disclosures by the Promoters were inadequate to inform the Plaintiffs of the Commissions and thus, insufficient to satisfy the Promoters fiduciary obligations.[111]

The lower court's opinion that the disclosure was inadequate indicates that broad, general disclosure language is not necessarily sufficient in a case where the investment promoter has a significant conflict of interest.

IV. CORPORATIONS

A. Books & Records

In *Barasch v. Williams Real Estate Co., Inc.*,[112] the First Department considered whether a director and minority shareholder of a corporation is entitled, on demand, to receive communications from the company's transaction counsel as they relate to the corporation and its transaction counsel, when the director, as shareholder, is in an adversarial relationship to the corporation.[113] The majority of the court overturned the motion court's decision for the director-shareholder and held that when a director asserts claims relating to her personal rights as a shareholder, which are or may be adverse to the corporation, she may not use her position as director to force the corporation to waive its rights to privileged attorney-client communications in litigation.[114]

The petitioner, Candace Barasch ("Petitioner"), a director and minority shareholder, commenced the special proceeding against Williams Real Estate Co., Inc. and other related entities (together, "Williams") to compel payment of the fair value of Petitioner's shares in accordance with Business Corporation Law section 623.[115] The proceeding was commenced after Williams sold a sixty-five percent interest in the company to a third-party investor, despite Petitioner's objection.[116] The transaction closed in October, 2008.[117] Upon commencement of the special proceeding, Petitioner served a broad discovery demand for all communications to or from Williams'

111. *Id.* at *16.
112. 104 A.D.3d 490, 961 N.Y.S.2d 125 (1st Dep't 2013).
113. *Id.* at 492, 961 N.Y.S.2d at 127.
114. *Id.*
115. *Id.* at 491, 961 N.Y.S.2d at 126; N.Y. BUS. CORP. LAW § 623 (McKinney 2014).
116. *Barasch*, 104 A.D.3d at 419, 961 N.Y.S.2d at 126.
117. *Id.*

transaction counsel, Moses & Singer, "concerning petitioner and the transaction."[118] Williams opposed, arguing that Petitioner "was not entitled to the attorney-client communications between Williams and its transaction counsel because she was in an adversarial relationship with Williams."[119] The motion court held for Petitioner, noting that "although [P]etitioner is now in an adversarial relationship with her codirectors and with Williams, she was not in an adversarial relationship during the time in question."[120]

Pursuant to the lower court's order, which was not appealed, transaction counsel then proceeded to spend "many hours conducting document review and produced more than 32,000 documents, including emails through October 8, 2008 (the date that [P]etitioner dissented from the underlying transaction)."[121] Months later, upon deposition of Williams' in-house counsel, Petitioner produced an email from transaction counsel to Williams dated September 24, 2008 which "described [P]etitioner as 'hostile' to the transaction, and warned Williams that [P]etitioner's attorneys could use provisions of the shareholder agreement to her benefit."[122] Williams' counsel objected to the question, "asserted the attorney-client privilege, and demanded the document's return, asserting that it was inadvertently produced."[123] In the aftermath, Williams demanded return of the email in question and another of the same date, where "counsel informed Williams that Petitioner would not cooperate and sign any documents, and explained [P]etitioner's dissenter's rights, her leverage and a possible 'blackmail' scenario."[124]

In its demand, Williams argued for return of the emails because Petitioner "had become adverse to her codirectors and Williams by September 8, 2008."[125] Petitioner filed a motion to compel delivery, and Williams "cross-moved for a protective order and for return of what they asserted are privileged documents that were inadvertently produced."[126]

Acknowledging that a director's right to inspect books and records is quite broad, including arguably the right to receive privileged

118. *Id.*
119. *Id.*
120. *Id.*
121. *Barasch*, 104 A.D.3d at 491, 961 N.Y.S.2d at 127.
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Barasch*, 104 A.D.3d at 491, 961 N.Y.S.2d at 127.

attorney-client communications, nevertheless, the First Department observed:

> This case involves a party who is both a corporate director and a shareholder, suing in her capacity as a shareholder and seeking to invade the corporation's attorney-client privileged communications about her, which took place at a time when she was adverse to the corporation, in order to advance her own interests as a shareholder. It is evident from the September emails that Williams's transaction counsel believed [P]etitioner to be hostile to the transaction and that it was advising Williams on how to handle [P]etitioner. Furthermore, that [P]etitioner retained separate counsel to represent her interests demonstrates that she did not believe that Williams's in-house counsel or transaction counsel were representing her interests as a shareholder. Thus, it is clear that as of September 8, 2008, [P]etitioner was in an adversarial position with Williams, and the attorney-client communications between Williams and its counsel regarding how to deal with [P]etitioner are privileged.[127]

The court went on to state:

> A director of a corporation "should not be allowed to use [her] corporate position to waive the privilege that attaches to the corporation in a litigation relating to [her] own rights or in which [she] is asserting claims that are or may be adverse to the corporation."[128]

Furthermore, the First Department criticized the motion court's holding which, in its view, "would thwart the purpose of the attorney-client privilege, which is to 'encourage full and frank communication between attorneys and their clients.'"[129]

One member of the First Department dissented, first on several procedural grounds, most notably, that the respondents were "not aggrieved by the ruling from which they appeal[ed]."[130] Moreover, in a careful review of the complex nature of the transaction and extended period of time that it took Williams and its transaction counsel to complete the reorganization, Judge Tom observed that in his view, Petitioner was "'not in an adversarial relationship during the time in question.'"[131]

Nevertheless, this case is a cogent reminder that a corporate

127. *Id.* at 492, 961 N.Y. S.2d at 127.

128. *Id.* (citations omitted).

129. *Id.* at 494, 961 N.Y.S.2d at 129 (quoting Upjohn Co. v. United States, 449 U.S. 383, 389 (1981)).

130. *Id.* at 495, 961 N.Y.S.2d at 129.

131. *Barasch*, 104 A.D.3d at 496, 961 N.Y.S.2d at 130.

director's near-to-absolute right to receive privileged communications may be compromised or lost when the director's role is blurred by a concomitant role as shareholder, and, as shareholder, personal interests are adverse to the corporation.

B. Shareholder Voting and Corporate Dissolution

In *East Midtown Plaza Housing Company, Inc. v. Cuomo,*[132] the Court of Appeals affirmed the decision of the First Department[133] and held, among other things, that the proposed privatization of a cooperative apartment complex, originally organized as a limited-profit housing company under the Mitchell-Lama Law,[134] constituted an offer and sale of securities within the meaning of the State's Martin Act[135] and required the filing of an offering statement with the State's Attorney General.[136] Further, the Court held that under East Midtown's certificate of incorporation, approval of a withdrawal from the Mitchell-Lama program required a two-thirds vote of outstanding shares entitled to vote, to be counted as one vote per apartment.[137]

1. The Facts.

As part of its privatization plan, East Midtown Plaza Housing Company, Inc. ("East Midtown") proposed to dissolve and transfer all of its assets "to a newly incorporated private cooperative, accompanied by a formal issuance of new shares in the entity."[138] The shares in East Midtown were not allocated equally among apartment units; rather, larger units were allocated a greater number of shares.[139] Nevertheless, East Midtown's certificate of incorporation specified "that each shareholder was entitled to one vote at shareholder meetings, regardless

132. 20 N.Y.3d 161, 981 N.E.2d 240, 957 N.Y.S.2d 644 (2012).

133. East Midtown Plaza Hous. Co. v. Cuomo, 85 A.D.3d 485, 926 N.Y.S.2d 404 (1st Dep't 2011).

134. N.Y. PRIV. HOUS. FIN. LAW art. II (McKinney 2014). Adopted by the Legislature in 1955, the law offers private housing companies financial incentives to develop low and moderate income housing. "The program 'encourages such housing by offering State and municipal assistance to developers in the form of long-term, low-interest government mortgage loans and real estate tax exemptions. In return for these financial benefits, developers agree to regulations concerning rent, profit, disposition of property and tenant selection.'" Matter of Columbus Park Corp. v. Dep't of Hous. Preserv. & Dev., 80 N.Y.2d 19, 23 (1992) (citations omitted).

135. N.Y. GEN. BUS. LAW art. 23-A (McKinney 2014).

136. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 170, 981 N.E.2d at 245, 957 N.Y.S.2d at 649.

137. *Id.* at 174, 981 N.E.2d at 248, 957 N.Y.S.2d at 652.

138. *Id*. at 167, 981 N.E.2d at 243, 957 N.Y.S.2d at 647.

139. *Id*.

of the number of shares owned."[140] At a shareholder meeting held in 2004 to approve the plan, two-thirds of East Midtown's shareholders voted for privatization, but the vote was problematic: "If the votes were counted on a per-share basis, the 2004 proposal achieved passage, but if the votes were counted on a per-apartment basis, the proposal did not garner sufficient votes for privatization."[141] The New York City Department of Housing Preservation and Development (HPD) and the New York State Attorney General subsequently informed East Midtown that

> a new vote was required because East Midtown had improperly held the privatization vote without first filing a cooperative offering plan with the Attorney General's office pursuant to the Martin Act. The Attorney General also notified East Midtown that, in accordance with the voting rights provision in East Midtown's certificate of incorporation, passage by two thirds of East Midtown's dwelling units, rather than two thirds of the outstanding shares, would be necessary for approval.[142]

East Midtown revised its proposal, and in 2008 the Attorney General accepted a new offering plan that "did not contemplate a transfer of property or a physical exchange of shares."[143] Rather, the revised plan "was to be effectuated by an amendment of East Midtown's certificate of incorporation."[144] Proponents of the new plan informed shareholders that HPD and the Attorney General's office had once again taken "the position that the privatization vote was to 'be conducted on an apartment by-apartment basis (*i.e.*, one vote per apartment) without regard to the number of shares held by each shareholder.'"[145] Nevertheless, proponents of privatization advised shareholders that they were reserving their right to challenge the voting requirement urged by HPD and the Attorney General's office.[146]

The vote taken in 2009 mirrored the 2004 result: the proposal had been approved so long as the votes were tallied on a one-vote-per-share basis; but failed to meet the two-thirds voting requirement if tallied on a one-vote-per-household basis, as provided in East Midtown's certificate

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140. *Id.*

141. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 167, 981 N.E.2d at 243, 957 N.Y.S.2d at 647.

142. *Id.*

143. *Id.* at 168, 981 N.E.2d at 243, 957 N.Y.S.2d at 647.

144. *Id.*

145. *Id.*

146. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 168, 981 N.E.2d at 243, 957 N.Y.S.2d at 647.

of incorporation and as directed by HPD.[147] In response, East Midtown

> filed a proposed second amendment to offering plan with the Attorney General. This amendment sought to declare the privatization plan "effective," stating that the 2008 plan had been adopted by "the affirmative vote of at least two thirds of the outstanding shares of East Midtown . . . by counting one vote per share." The Attorney General refused to accept the amendment.[148]

East Midtown then commenced an Article 78 proceeding to compel the Attorney General to accept its second amendment, declaring the privatization plan effective and directing HPD to acknowledge

> that the plan achieved the necessary two-thirds shareholder vote under the one-vote-per-share formula. The petition also sought a declaration that the Attorney General lacked jurisdiction over East Midtown's efforts to exit the Mitchell-Lama program on the theory that the Martin Act did not apply to the transaction.[150]

Two tenant groups ─ each on opposite sides of the privatization issue ─ intervened in the litigation.

Ultimately, the First Department affirmed the lower court's denial of East Midtown's petition and dismissal of the proceeding.[151] The Court of Appeals affirmed.[152]

2. Analysis: the Martin Act and Federal Securities Law

Despite East Midtown's argument to the contrary, the Court, fully in accord with the Attorney General's assertion, held that, "however it is packaged, the privatization of a Mitchell-Lama cooperative complex comfortably falls within the parameters of the Martin Act."[153] The Court stated that:

> The Martin Act regulates the offer and sale of securities within or from New York. The Attorney General is responsible for "implementing and enforcing the Martin Act, which grants both regulatory and remedial powers aimed at detecting, preventing and stopping fraudulent securities practices." As relevant here, the Martin Act makes it illegal for a person to make or take part in "a public offering or sale" of securities consisting of participation interests in real estate, including cooperative apartment buildings, unless an

147. *Id*. at 168, 981 N.E.2d at 243-44, 957 N.Y.S.2d at 647-48.
148. *Id*. at 168, 981 N.E.2d at 244, 957 N.Y.S.2d at 648.
150. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 168, 981 N.E.2d at 244, 957 N.Y.S.2d at 648.
151. *Id.*
152. *Id.*
153. *Id.* at 169, 981 N.E.2d at 244, 957 N.Y.S.2d at 648.

> offering statement is filed with the Attorney General. The purpose of the disclosures required in an offering plan is to safeguard the purchasers of cooperatives and condominiums by mandating "full disclosure of risks" and promoting "unit purchasers' self-protection by analysis of risks."[154]

Next, the Court observed that "changes in the rights of the holders of existing securities can amount to a 'purchase or sale' within the meaning of federal securities laws."[155] The Second Circuit test "is whether there has been such a 'significant change in the nature of the investment or in the investment risks as to amount to a new investment."[156] The Court also noted other considerations, including that: "[c]oncepts of purchase and sale are to be construed flexibly in order to accomplish the purpose of the securities laws,"[157] a transaction might "lend[] itself to fraud in the making of an investment decision,"[158] and "the pertinent inquiry focuses on the economic reality of the transaction."[159] The Court summed up its analysis by observing:

> We have applied a similarly adaptable standard in ascertaining whether an interest qualifies as a "security" within the meaning of the Martin Act, recognizing that substance and economic reality will control over form.[160]

Applying that analysis, the Court noted that "the privatization of East Midtown's cooperative apartment complex would result in a number of substantial changes to the nature of its shareholders' interests."[161] For example, with privatization, residents would be able to sell their shares at market rates, in contrast to the resale limitations established by Mitchell-Lama, a fact acknowledged by East Midtown.[163]

In addition, with privatization, a host of consequences would

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154. *Id*. at 169, 981 N.E.2d at 244-45, 957 N.Y.S.2d at 648-49 (citations omitted). In footnote three of its decision, the Court stated: "Plainly, the Martin Act applies to the conversion of a rental apartment building into a cooperative building. The question posed by this appeal is whether the act further applies to the privatization of an already-existing Mitchell-Lama cooperative apartment complex." *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 169 n.3, 981 N.E.2d at 244 n.3, 957 N.Y.S.2d at 648 n.3 (citations omitted).

155. *Id.* at 170, 981 N.E.2d at 245, 957 N.Y.S.2d at 649.

156. *Id*. (citing Gelles v. TDA Indus., 44 F.3d 102, 104 (2d Cir. 1994)).

157. *Id.* (citing 3 Hazen, Securities Regulation § 12.6(1) at 557 (6th ed. 2009)).

158. *Id.*

159. *Id*. (citation and internal quotation marks omitted)..

160. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 170, 981 N.E.2d at 245, 957 N.Y.S.2d at 649 (citing All Seasons Resorts v. Abrams, 68 N.Y.2d 81, 88, 497 N.E.2d 33, 36-37, 506 N.Y.S.2d 10, 13-14 (1986)).

161. *Id*.

163. *Id*. at 170-71, 981 N.E.2d at 245-46, 957 N.Y.S.2d at 649-50 (citation omitted).

follow, such as:

> East Midtown's loss of eligibility for government–subsidized financing and property tax reductions available under Mitchell-Lama. Other significant alterations upon privatization would include the imposition of a 45% transfer fee or "flip tax" to be paid to East Midtown from the proceeds of the first sale of shares; the possibility that individual shareholders would become disqualified for government programs for persons in need; and potential increases in maintenance charges. In short, the changes affecting shareholders are substantial enough to constitute a different investment such that the proposed privatization can fairly be characterized as a "offering or sale" of securities under the Martin Act.[164]

Having thus eviscerated East Midtown's privatization arguments as "form over substance," the Court then moved on to consideration of the vote required for approval.

3. The Vote

Contrary to East Midtown's contention, the Court affirmed the position of HPD and the Attorney General that both the Business Corporation Law and an HPD regulation required that the shareholder vote to privatize must be counted on a one-vote-per-apartment basis.[165] The Court, however, disagreed with the HPD and the Attorney General that this standard was not supported by the language in East Midtown's certificate of incorporation.[166] In an elegant parsing of law and language, the Court noted that

> East Midtown's certificate of incorporation . . . expressly provides that its shareholders "shall be entitled to one vote at any and all meetings of stockholders for any purposes regardless of the number of shares held by such holder, except as otherwise provided by statute." In other words, as East Midtown acknowledges, the certificate generally establishes a one-vote-per-apartment formula.[167]

The Court then dismissed East Midtown's interpretation of section 1001 of the Business Corporation Law, which generally governs dissolution of a corporation.[168] The Court noted first that, while the provision does indeed permit dissolution of a corporation by "two-thirds of the vote of all outstanding shares," the sentence is completed by the

164. *Id*. at 171, 981 N.E.2d at 246, 957 N.Y.S.2d at 650.

165. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 171, 981 N.E.2d at 246, 957 N.Y.S.2d at 650.

166. *Id*. at 171-72, 981 N.E.2d at 246-47, 957 N.Y.S.2d at 650-51.

167. *Id.* at 172, 981 N.E.2d at 246, 957 N.Y.S.2d at 650.

168. *Id*. at 172, 981 N.E.2d at 247, 957 N.Y.S.2d at 651.

words, "entitled to vote thereon."[169] Therefore, "[i]n substance, the one-vote-per-apartment rule set forth in East Midtown's certificate of incorporation entitles the holder of shares to one vote at stockholder meetings."[170] The Court went on:

> Second, the reference to "all outstanding shares" in section 1001 clarifies that a dissolution vote must be passed not merely by two thirds of those voting at the shareholder meeting (*see* Business Corporation Law § 614(b) [unless otherwise specified in the in the Business Corporation Law, votes are to be calculated by reference to those present and voting at a quorum meeting]), but by a supermajority of all shareholders in the company. Finally the thrust of section 1001 is directed to how corporate shareholders may authorize dissolution; the statute does not purport to calculate the relative weight to be given to each share entitled to vote.
>
> Instead, a different provision of the Business Corporation Law specifically addresses shareholder voting rights. Business Corporation Law § 612(a) states that "[e]very shareholder of record shall be entitled at every meeting of shareholders to one vote for every share standing in his name on the record of shareholders, *unless otherwise provided in the certificate of incorporation*" (emphasis added). Section 612 therefore establishes a default rule of one vote per share. But it allows corporations to adopt a different vote-count methodology in their certificates of incorporation. And East Midtown did just that, it selected a one-vote-per-household voting formula in its certificate of incorporation. Because the Business Corporation Law does not mandate any specific method of vote calculation, we believe that East Midtown's certificate of incorporation controls.[171]

The Court then harmonized that conclusion with the language of the HPD regulation. While the regulation may require that the "[d]issolution and/or reconstitution of the mutual housing company requires approval of two-thirds (2/3) of the outstanding shares of the corporation,"[172] nevertheless, the regulation concludes with the words "as mandated by the Business Corporation Law."[173] The Court observed that,

> [a]lthough the regulation may have been inartfully worded, it incorporated by reference and tracked Business Corporation Law

169. *Id.* (quoting N.Y. Bus. Corp. Law § 1001(a)(ii) (McKinney 2012)).

170. *East Midtown Plaza Hous. Co.*, 20 N.Y.3d at 172, 981 N.E.2d at 247, 957 N.Y.S.2d at 651 (footnote omitted).

171. *Id*. at 172-73, 981 N.E.2d at 247, 957 N.Y.S.2d at 651 (footnote omitted).

172. *Id*. at 173, 981 N.E.2d at 247, 957 N.Y.S.2d at 651 (citation omitted).

173. *Id*. (citation omitted).

> § 1001(a)(ii). For the same reasons that lead us to conclude that no conflict exists between the Business Corporation Law and East Midtown's certificate of incorporation, the HPD regulation can be read compatibly with the certificate of incorporation.[174]

With that final flourish, the Court not only affirmed the holding of the First Department, but provided an elegant lesson in statutory exegesis.

V. DERIVATIVE ACTIONS.

In *Gabel v. Gabel,*[175] plaintiffs Gabel Equipment Corporation ("the Corporation") and one of its shareholders, Christopher Gabel, brought an action under sections 626 and 720 of the BCL[176] for diversion of corporate assets and breach of fiduciary duty against, among others, Paul V. Gabel, formerly the President of the Corporation, who allegedly diverted assets from the Corporation in violation of his fiduciary duty.[177] One of the plaintiffs' causes of action sought a declaratory judgment that, some time before Christopher became a shareholder, the Corporation had invalidly agreed to make retirement payments to Paul.[178] The defendants asserted that this cause of action should be dismissed in accordance with BCL section 626(b)[179] because Christopher was not a shareholder at the time of the disputed transaction.[180]

BCL section 720(b)[181] authorizes a corporation or any of its

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174. *Id*. at 173, 981 N.E.2d at 247-48, 957 N.Y.S.2d at 651-52.

175. 104 A.D.3d 910, 961 N.Y.S.2d 569 (2d Dep't 2013).

176. *Id.* at 910, 961 N.Y.S.2d at 570, referring to N.Y. BUS. CORP. LAW §§ 626(b) and 720(b) (McKinney's 2014).

177. *Id.* at 911, 961 N.Y.S.2d at 570.

178. *Id.*

179. BCL sections 626(a) and (b) provide in relevant part:

> (a) An action may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor, by a holder of shares or of voting trust certificates of the corporation or of a beneficial interest in such shares or certificates.
>
> (b) In any such action, it shall be made to appear that the plaintiff is such a holder at the time of bringing the action and that he was such a holder at the time of the transaction of which he complains.

N.Y. BUS. CORP. LAW §§ 626(a), (b) (McKinney 2014).

180. *Gabel*, 104 A.D.3d at 911, 961 N.Y.S.2d at 571.

181. BCL sections 720(a) and (b) provide in relevant part:

> § 720. Action against directors and officers for misconduct.
>
> (a) An action may be brought against one or more directors or officers of a corporation to procure a judgment for the following relief:
>
> (1) . . . [T]o compel the defendant to account for his official conduct in the following cases:
>
> (A) The neglect of, or failure to perform, or other violation of his duties in the

directors or officers to bring an action for waste or breach of fiduciary duty, without meeting a requirement similar to section 626(b) that, at the time in question, the plaintiff had held a director or officer position.[182] Accordingly, the court permitted the Corporation, although not Christopher, to pursue the declaratory judgment action.[183]

CONCLUSION

During the *Survey* period, case decisions continued to develop principles of the law of business associations by considering how the principles should apply to current disputes. Also in the *Survey* period, the Legislature defined related-party transactions in the case of not-for-profit corporations, although the effects of the legislation may take years to make themselves evident.

> management and disposition of corporate assets committed to his charge.
> (B) The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties.
> . . . .
> (b) An action may be brought for the relief provided in this section . . . by a corporation, . . . receiver, trustee in bankruptcy, officer, director or judgment creditor thereof, or, under section 626 (Shareholders' derivative action brought in the right of the corporation to procure a judgment in its favor), by a shareholder, voting trust certificate holder, or the owner of a beneficial interest in shares thereof.

N.Y. BUS. CORP. LAW §§ 720(a), (b) (McKinney 2014).

182. *Gabel*, 104 A.D.3d at 911-12, 961 N.Y.S.2d at 571.

183. *Id.* at 912, 961 N.Y.S.2d at 571.