

SPECIAL EDITION
350 BLEECKER STREET CO-OP NEWSLETTER #141
October 27, 2001

This newsletter is a summary of the October 24 meeting for shareholders qualified to vote on the garage lease termination. The meeting started at 7:30 PM and ended around 11:15 PM. About 30 shareholders attended, including the complete board. Susan Kim, the board president, moderated the discussion.

Susan introduced Andrew Brucker, the attorney for 350 Bleecker, whose firm also represents about 120 other co-ops, and who teaches seminars for the co-op association. Susan also introduced attorneys Bob Fass and Walter Goldsmith, who represented 350 Bleecker when Ken Newman sued the co-op over the garage lease termination. Walter and Bob's firm represents about 50 other co-ops. Walter is a published expert on the federal Co-op/Condo Abuse Relief Act.

The board distributed an outline agenda for the meeting, but some people preferred that certain issues be addressed contrary to the outlined sequence. The meeting started with several shareholders who were very angry, but as the evening progressed, and information was shared, the anger level was progressively reduced. After a couple of hours, everyone unanimously agreed on the actions to take next. So a consensus was achieved, which seemed remarkable, considering all the pressure and hostility many people felt at the beginning of the meeting.

Unfortunately, this meeting only included about a third of the shareholders and several left the meeting before the consensus was agreed upon.

The board members were unhappy about the multiple memos of misinformation distributed in the previous few days. Although quite detailed, many essential "facts" presented were incorrect. The board wanted to outline the major errors in these memos, but the shareholders attending the meeting preferred to learn about other issues first.

By the end of the meeting, every topic in the outline was discussed, but not in the original order. For purposes of clarity, this newsletter summarizes the information presented, but not exactly in the sequence of its actual or intended presentation.

WHY THE CO-OP LOST THE LAWSUIT IN THE LOWER COURT

The number of apartments controlled by the sponsor, versus the number of "sold" apartments, partially determines when a termination vote may take place.

Issue #1 – how many apartments do we have?

The judge needed to determine the number of apartments in our building. When apartments were combined, Ken, as managing agent and transfer agent, did not consistently issue new stock certificates and proprietary leases reflecting the changes. However, the changes were reflected in the board minutes and in the NYC Department of Buildings filings.

Judge Lynch did not focus on the board minutes or the Department of Buildings filings. He focused only on certain inaccurate records (stock certificates and proprietary leases) maintained by Ken Newman. Based on this, the judge ruled that we should have held the garage vote earlier. **For example, had the 1999 vote succeeded (it lost by 3 votes), Judge Lynch would have accepted the termination.**

Issue #2 – holders of unsold shares

Ken sold an apartment to his secretary, Shirley Lomanto, and to his lawyer's secretary, Kathleen Iwanczuk. Ken's lawyer did the original co-op filing with the Attorney General in 1985. The judge ruled that these 2 apartment owners were not closely tied to Ken Newman. This meant that the count of "Ken's apartments" was reduced, which also required the co-op to win the garage termination vote earlier (1999 instead of 2000).

DEMAND FOR LEGAL FEES

Ken is expected to demand that the co-op pay his legal fees, which are said to be at least \$270,000. The co-op will challenge this figure and there will be fact-finding to determine what is reasonable. The co-op spent about \$75,000 for its lawyers, and other co-ops in more complicated cases spent about \$100,000 for their lawyers, so the \$270,000 figure may be excessive.

Judges often reduce legal fee requests substantially. Walter Goldsmith quoted a recent case where the fee was reduced 80%.

HOW WOULD THE CO-OP PAY KEN'S LEGAL FEES?

As of the end of September, the co-op had \$280,000 in cash, a figure very close to its budget. We expect to end the year with about \$100,000 to \$125,000. Our mortgage bank requires us to have \$100,000 cash on December 31 of every year.

The bank offered to lend the co-op at least \$500,000, or possibly more if needed, with a "line of credit" at about 6% interest. In other words, should we need extra cash, we can borrow it, paying interest-only if we wish, for about 4 years. In 4 years, our regular mortgage ends, and the refinancing might include the line of credit debt, if appropriate. The interest is tax-deductible.

WHAT ARE THE CO-OP'S ALTERNATIVES NOW?

There are 4, and some can be combined:

I. Appeal the decision

The "Notice of Appeal" must be filed by November 2. The court will not allow an extension. Within several weeks of the notice filing, the co-op must file the detailed papers explaining why we believe the decision is wrong. Walter and Bob offered to do all the appeal work for \$15,000 plus \$2,000 expenses (for special printing required by the court), with the money due in late January. Simply filing the notice would only cost about \$1,000, of the \$17,000 mentioned above. **A \$17,000 legal fee would not cause an assessment, since it is less than 2% of the co-op's total budget (about 8 cents per share per month for 1 year).**

The appeal would take an estimated 3 to 6 months, and there could be 3 possible outcomes:

- A. the co-op wins its argument that the judge erred. This can only be appealed to the US Supreme Court, which is unlikely
- B. the lower court is completely correct and the suit ends forever, or
- C. the lower court erred and must re-try part of the case, with the higher court's guidance. Any decision the lower court then makes can be appealed again.

Walter, Bob, and Andrew said that "A" and "C" are the most likely outcomes. In common law, when papers disagree (such as the correct number of apartments) most judges look at the entire set of records, not just the records filed and maintained by only one party to the case.

Furthermore, all 3 lawyers believe that the judge did not understand that the two secretaries' shares have been treated with the same rights as Ken's shares. For example, they have not paid sublet fees for 16 years.

People at the meeting wanted to know if the co-op should seek a "second opinion" from another, disinterested attorney. Andrew Brucker explained that he is disinterested and neutral, because he gets no fees from the garage case, since his firm is not the same as Bob and Walter's firm. (Although not mentioned at the meeting, Andrew Brucker had been hired by the previous board, which included Ken Newman and Steven Hanley. The current board hired Walter and Bob.)

Walter, Bob, and Andrew explained that garage cases are frequently appealed, no matter who wins, because millions of dollars are at stake. For example, *5 West 14 Street* and *2 Tudor City* both won their garage cases on appeal. If the co-op wins the appeal, then the legal fees paid to Ken Newman would be refunded.

All 3 lawyers strongly advised filing the Notice of Appeal by November 2. **By the end of the meeting, all shareholders agreed unanimously.** The attorneys told the board after the meeting that the actual commitment to completing the appeal must be decided by November 20, to allow time to complete the paperwork.

II. Mediation and negotiation

The board could again suggest hiring a neutral non-binding mediator to help create a compromise settlement. The board suggested this in the past, but Ken was not interested. Regardless of whether a mediator is hired, the board could again suggest negotiations with Ken. A continued struggle in the courts creates risk and expense for Ken as well as the co-op. **Mediation and negotiation can take place while court proceedings occur, regardless. The shareholders at the meeting agreed unanimously that this should be suggested to Ken immediately.**

Questions were raised about previous negotiations. Ken and the board attempted to reach a settlement without a mediator, but the board could not communicate all the details at the time, because Ken insisted that the board sign a letter of confidentiality. All shareholders were told about this in the newsletter at the time, and asked if they wanted to sign the confidentiality agreement too, so they could learn the important details. No shareholder came forth to sign the agreement, so the board could not communicate the offers both sides made.

For example, Andrew Brucker suggested that Ken simply split the garage profit 50:50 with the co-op, up to the limit of the 80/20 tax rule. This would've given the co-op about \$100,000 a year more, and Ken would still keep about \$100,000 in profit from the garage. Everyone's maintenance (including Ken's) could go down about 10%. Ken considered this for a few days, but then rejected the co-op's offer. A shareholder asked if the negotiations were done in a hostile manner. Actually, they were quite cordial business discussions, letters, and e-mails. This is a business issue, not a personal one.

III. Start a lawsuit against Ken in state court for improper fiduciary conduct.

If the co-op loses the garage, a case can be made that Ken caused the loss since he did not keep corporate records properly (the share certificates and leases for the combined apartments). Furthermore, Ken concealed the existence of the federal Condo/Co-op Abuse Relief Act for 15 years, which is a violation of the state Martin Act.

There is no immediate deadline for this lawsuit to be filed. One attorney quoted a \$40,000 price for this. Ken's liability might be the value of the garage, any legal fees paid by the co-op for the federal case, and all of Ken's managing agent and transfer fees for 15 years. No one at the meeting thought this was urgent right now.

IV. Give up the garage struggle and surrender.

This would save legal fees in the future, but the co-op would still be liable for Ken's legal fees. The garage lease would continue "as-is". In other words, the co-op would continue to receive about \$35,000 per year for the garage space, while Ken would receive around \$200,000 in rent from the operator.

HISTORY OF THE GARAGE VOTES

I. 1999 vote

The lease termination requires two-thirds of the shareholders, excluding the sponsor, to vote yes. The 7 member board split: Ken was against termination, but could not vote. However, he was 1 of the 7 board members, since he was president of the co-op. Three board members (Steven Hanley, Bob Mishkin, George Ong) voted against termination. Three board members voted to terminate the garage portion of the commercial lease (Bob Bangiola, Jim Kafadar, Mark Lilien).

Ken Newman threatened in writing to sue any shareholder individually who voted in favor of termination. Ballots were open, not secret, so confidentiality was not protected. Ken had previously advised the board that an apartment with multiple owners (such as a married couple) was required to have all owners sign a proxy to be valid, so proxies signed by only 1 owner were rejected. In reality, the law is exactly the opposite, only 1 owner need sign a proxy. But the board had no independent legal advisor, so everyone followed Ken's advice as to the law. As a result, at least 1 vote in favor of termination was illegally rejected.

The shareholders came to several meetings, many fliers were handed out, and the election was lost by 3 votes. The board voted against hiring an outside attorney, because under the board's rules, at least 4 votes were required to hire an attorney.

After the vote lost, Steven Hanley, Bob Mishkin, and George Ong distributed a letter on July 1, 1999 to all shareholders nominating themselves to negotiate with Ken to change the master lease for the stores and garage. They suggested that they might improve the rent paid to the co-op. They remained on the board for 4 months after July 1, but their negotiations failed.

II. Year 2000 vote

Ken was no longer on the board. The board members were all residents of the building with no conflicts of interest (no real estate brokers, no attorneys, no contractors, no managing agent, no sponsor). The seven board members hired Walter and Bob to advise, after talking with 2 other firms. After several months of consultation, the board endorsed the termination unanimously. For the first time, ballots were secret, to protect confidentiality. **Ken Newman again threatened in writing to sue any shareholder voting to terminate.** Every voting shareholder ignored the threat and voted to terminate (unanimous).

TAX DISCUSSION

Co-ops may not pass through their tax deductions (for interest and real estate taxes) to their shareholders if they receive less than 80% of their income from their own shareholders. Since our budget is about \$1.2 million, the co-op can collect about \$240,000 from the commercial spaces without exceeding the 80/20 rule. Since we only collect about \$110,000 from this space today, we could increase our income, and simultaneously reduce our yearly maintenance, by about \$130,000, equal to \$7.55 per share. Over 59 years, this totals \$7.7 million.

This would be a 12% maintenance reduction. The co-op received this advice from several CPA's as well as its attorneys. When the board unanimously suggested termination, they pledged that any additional income would go towards reducing everyone's maintenance.

Co-ops whose commercial rents might rise to exceed the 20% limit usually respond by simply keeping the rents “below market” to keep their tax deductions.

BACKGROUND AND PROVISIONS OF THE FEDERAL CONDO/CO-OP RELIEF ACT

The law was passed because Congress was unhappy about real estate developers’ self-dealing. In other words, a real estate developer would bind his/her project to a long-term contract that would not pay reasonable market rents to the true owners of the property. For example, Ken pays the co-op about \$110,000 a year for the stores and garage. This lease has about 59 years to run. The current market rents for the stores and garage are approximately \$800,000. Even if Ken’s rents are only 75% of that figure, his profit would be about \$10,000 per week.

The law allows us to terminate a self-dealing contract for a community facility, such as a laundry room or a garage. The stores are not considered to be community facilities, so that part of the lease cannot be terminated for 59 years.

HOW OUR ATTORNEYS WERE PAID

They offered to do the work for hourly rates, estimated at \$75,000, or on a contingent basis. The garage’s market value was estimated at \$2 million to \$3 million. At the time Ken sued the co-op to stop the lease termination, many shareholders told board members that paying \$75,000 was a better deal than paying a \$1 million contingency fee. This year’s assessment of 39 cents per share went toward paying the legal fees.

CONCLUSION

The board is filing a Notice of Appeal and is asking Ken Newman again if he’d like to share the cost of a neutral mediator. The full cost of a mediator would be approximately \$3,000 to \$6,000. The board is also asking Ken if he’d like to negotiate without a mediator. The decision to commit to the full appeal for \$17,000 will be postponed as long as possible.