2023-09-07

Fowley v James

SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. ARLENE P. BLUTH** **PART** **14**

Justice

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INDEX NO. 154054/2023

CHRISTINE FOWLEY, MARY FOUTZ, MARY WADE, SHARON TORRES,

MOTION DATE 09/07/2023

Petitioners,

MOTION SEQ. NO. 002

- v -

LETI IA JAMES as Atto ney Gen ra of the S ate o New York, OA D OF DIRE TO S OF C DMAN TO ERS, INC.,

DECISION + ORDER ON MOTION

Respondents.

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The following e-filed documents, listed by NYSCEF document number (Motion 002) 1- 6, 18, 24, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 48, 49, 50, 51

were read on this motion to/for ARTICLE 78.

The petition to annul the no action letter of respondent Attorney General ("AG") is granted only to the extent that the matter is remanded to the AG for reconsideration of the conversion proposal.

Background

Petitioners are shareholders and residents of the Cadman Towers, a 421-unit Mitchell-Lama cooperative in Kings County. Petitioners bring this proceeding to prevent the conversion of the building to a Housing Development Fund Company ("HDFC") cooperative under the Private Housing Finance Law. They claim that this would be the first ever conversion of a Mitchell-Lama building to an HDFC.

Petitioners claim that the proxy statement offered by respondent the Board of Directors of Cadman Towers, Inc. (the "Board") in support of the conversion is unclear and fails to articulate

the risks associated with the conversion. They complain that the AG's decision to allow the Board to hold a vote of the shareholders contravenes applicable regulations and is irrational because it failed to adequately inform the shareholders (the voters) about the dangers of this conversion.

Petitioners explain that although Mitchell-Lama and HDFC buildings both offer affordable housing options, HDFCs often lack caps on resale prices, which means that shareholders leaving a building will realize significant returns when selling their shares. Petitioners contend that the AG improperly issued a no-action letter.

Petitioners admit that in 2021, the Board submitted an application to the AG for an exemption from the requirement that they file an offering plan in connection with the proposed conversion. Included in this application was a proxy statement, not an offering plan. They allege that after comments and revisions, the AG did not issue an exemption as requested by the Board; instead, it issued a no-action letter on February 15, 2023 permitting the conversion to proceed to a shareholder vote. A no-action letter is not exactly same as granting an exemption. Shareholders then received a copy of the final proxy statement on February 28, 2023.

Petitioners contend that the Martin Act (codified in the General Business Law) prohibits any offerings of real property unless the AG accepts an offering plan. They stress that under the AG's own rules, it cannot issue a no-action letter related to an offering where it involves more than 10 units (here, the complex has more than 400 units). Petitioners acknowledge that the AG published a memorandum in 2013 that set forth a process for an exemption related to conversions. They argue that despite this memo, the AG's issuance of the subject no-action letter violates the AG's own regulations.

Petitioners conclude that the information contained in the final proxy statement is unclear and contradictory. They identify four areas in which the provided information is lacking, including the proposed regulatory agreement, income surcharges, family member transfers and the flip tax. Petitioners observe that the regulatory agreement was not included with the proxy statement, there is contradictory information about surcharges and family membership transfers and the Board failed to disclose the risks associated with the revenue to be generated from flip taxes. They observe that the value proposition from the Board relies on revenue to be generated from flip taxes, despite the fact that such revenue will likely decrease over time after units complete their first sales.

The AG insists that petitioners failed to state a claim as there is no evidence that the AG issued an arbitrary or capricious decision. It maintains that there is highly deferential standard applied to the instant circumstances and that it ensured that shareholders at the building received the requisite information.

The AG explains that accepting the final proxy statement without a copy of the proposed regulatory agreement was not irrational and that the regulatory agreement cannot be produced prior to the acceptance of the proxy statement itself. And the AG observes that the regulatory agreement term sheet provides the key details about the regulatory agreement to shareholders. With respect to the income surcharge issue, the AG observes that a footnote in the proxy statement explicitly noted that the surcharge income formula used by HPD would apply to the proposed HDFC. The AG insists that the issue was therefore directly addressed in the proxy statement.

With regard to the issue of family member transfers, the AG notes that the First Amendment to the proxy statement (NYSCEF Doc. No. 44) clearly addresses it. The AG

questions how petitioners could simultaneously argue that there was inconsistent information about this issue and also conclude that family member transfer rights would be diminished. Regarding flip taxes, the AG also insist that the proxy statement specifically noted that flip taxes (and the revenue generated by them) may be speculative. It emphasizes that the First Amendment (cited above) contains a breakdown of how flip taxes might be handled in three different situations.

The AG directs the Court to the June 2, 2023 supplemental email, which was sent well after this petition was served and filed. In it, the AG asserted (in part) that:

> "Pursuant to the authority to grant an exemption and also to issue a NAL under General Business Law Section 352-e and New York Codes Rules and Regulations, Title 13, Part 18, the DOL granted an exemption as requested in the NAL Application as of February 15, 2023 and issued a no-action letter. The DOL granted an exemption of the applicability, if any, of the Martin Act requirements as requested in the NAL Application." (NYSCEF Doc. No. 43).

The AG observes that whether or not the Martin Act applies to the conversion at issue here, a proxy statement is appropriate filing because the Martin Act merely requires that purchasers have adequate disclosures. It claims it was entitled to discharge its obligation by granting an exemption in a no-action letter after determining that the final proxy statement was satisfactory.

The Board claims that it entered into a regulatory agreement with the New York City Housing Development Corporation in June 2021, a decision that did not require shareholder approval. It claims that in 2021, the Board submitted an application for an exemption from filing an offering statement or prospectus with the AG in connection with the conversion to an HDFC. It points to a memorandum from the AG dated 2013, which provided that Mitchell-Lama cooperatives that want to covert to an HDFC can provide shareholders with a proxy statement in lieu of an offering plan as long as certain minimum disclosure requirements are met.

The Board says it complied with that requirement by submitting a 249-page proxy statement to the AG, after which the AG issued a no-action letter. It characterizes petitioners as four shareholders who make up only 1% of all shareholders. The Board acknowledges that on June 2, 2023 (again, which is after the petition was served and filed) the AG supplemented its initial no-action letter with a "supplemental letter" in which it claims it granted an exemption to the requirement that an offering statement or prospectus be filed with the AG. The Board insists that the proxy statement clearly satisfied the disclosure requirements in General Business Law § 352-e(1)(b).

Petitioners insist in reply that this is the first time a Mitchell-Lama cooperative might be converted to an HDFC and so all shareholders must rely upon the information provided by the Board when voting on the proposed conversion. They insist that the actions taken by respondents after this case was served and filed, including the AG's "clarification" email in June 2023 and the Board's first amendment to the proxy statement, show that their concerns are valid. Petitioners argue that although this additional information provides more clarity, they still do not have a copy of the 99-year regulatory agreement and there is still no adequate summary provided to shareholders about family succession rights going forward. They also insist that the proposed maintenance surcharge might be deemed unlawful, which would purportedly put a half-million-dollar hole in the Board's annual budget.

Petitioners claim that residents should be provided with the information they need before a vote is scheduled. They insist that there is no question that the Martin Act applies to this proceeding. Petitioners maintain that the AG acted arbitrarily by exempting the Board's application after this proceeding was commenced. While petitioners acknowledge that the AG

has the power to exempt applicants from certain requirements, they insist its application here is irrational.

Discussion

The instant conversion is clearly covered by the Martin Act as the AG's June 2023 supplemental letter (which will be discussed in greater detail below) cites to the Martin Act. And there is no dispute that the AG has the power to issue an exemption from applicable regulations. The question in this case is whether the AG met its burden to justify its actions here.

This Court's analysis must begin with the no-action letter in February 2023 upon which this case is based. The AG stated that "The Department of Law ("DOL") has granted the issuance of a no-action letter pursuant to the above-referenced no-action letter application ("NAL Application") as of February 15, 2023. The DOL will not take enforcement action based on the transaction(s) described in the NAL Application" (NYSCEF Doc. No. 4).

Of course, the AG's actions did not end there. Curiously, well after this case began, the AG issued another no-action letter on June 2, 2023 that it classifies as "supplemental" where, for the first time, the AG claims it "granted an exemption as requested in the above-referenced no-action letter application ("NAL Application") and issued a no-action letter. This email does not change the date of the exemption and no-action letter's issuance" (NYSCEF Doc. No. 31). No mention was made in the first no-action letter about an exemption of any kind or the basis for granting such an exemption.

And the Court observes that the Board's First Amendment to the proxy statement was accepted for filing on June 15, 2023 (NYSCEF Doc. No. 34) and it appears to have been submitted on June 8, 2023 (NYSCEF Doc. No. 32), all after this proceeding was filed.

The above timeline compels the Court to grant the petition, but only to the extent that the matter is remanded back to the AG so that it can evaluate the First Amendment to the proxy statement and explain why an exemption from the Martin Act's requirements is, or is not, permitted. Any objective evaluation of the Board's First Amendment to the proxy statement reveals that it contains significantly more detailed information about the conversion proposal.

The Court finds that while the Board was entitled to amend the proxy statement, the fact is that the AG's no-action letter was issued well before this amendment was uploaded. Therefore, petitioners are entitled to see whether the AG's position on granting an exemption still applies to this recent filing, and, if so, why the AG takes that position. Although it appears that the AG "accepted" the First Amendment to the proxy statement, there is no indication whether the no-action letter applies to the now-pending proposal nor are there any details about the AG's view on this new filing.

Another issued raised in the papers is the inclusion (or lack thereof) of the proposed regulatory agreement. The "exemption" that the AG purports to provide arises from a 2013 AG memorandum. That memorandum provides that "Notwithstanding, a ML Cooperative proposing to convert to an HDFC Cooperative may provide shareholders with a Proxy Statement in lieu of an offering plan, so long as the minimum disclosure requirements set forth herein are met" (NYSCEF Doc. No. 3). One of the required documents cited in paragraph 19 to be disclosed is the proposed regulatory agreement (*id.* ¶ 19).

No party suggests that a regulatory agreement was included as part of the instant proposal. The Board argues that the entire proposed regulatory agreement cannot be attached because "HPD is unable to draft the entire regulatory agreement prior to the shareholders voting in favor of the Conversion" (NYSCEF Doc. No. 29 at 13). This is yet another issue the AG must

address—does the regulatory term sheet (included instead of the actual agreement) suffice to adequately inform the shareholders despite the fact that the AG's own 2013 memo requires the inclusion of the agreement, not just a term sheet.

The request for legal fees is denied as the moving papers did not cite a basis for the award of such fees.

Summary

The Court's role in the instant dispute is not to dissect every line of the proposed conversion plan or make its own assessment about whether or not conversion is appropriate. The Court must only assess if the AG's decision to issue the no-action letter was rational. The Court finds that the AG must reconsider whether or not the Board should be entitled to an exemption given the recent filing by the Board.

After all, the AG made clear in its "supplemental" decision dated June 2, 2023 that "This email does not change the date of the exemption and no-action letter's issuance" (NYSCEF Doc. No. 31). It may be that upon remand, the AG finds that the updated information from the Board, including the proxy statement and the amendment, provide enough clarity, particularly with respect to the issues raised by petitioners (including transfers to family members, surcharges and flip taxes).

Put another way, the undisputed circumstances of this case compel the Court to grant the petition to the extent that it must be remanded to the AG and the shareholder vote may not proceed until after a subsequent AG determination. Only after petitioners brought this case did the AG "explain" that it had granted an exemption and only after petitioners brought this case did the Board include an amendment to the proxy statement providing more detail about the very

issues raised by petitioners. The Court is unable to find that that the AG's initial no-action determination applies to these later events.

Accordingly, it is hereby

ORDERED that the petition is granted only to the extent that the dispute is remanded back to the Attorney General's Office which must reconsider the Board's proposal in light of both the concerns raised by petitioners and the first amendment submitted by the Board.

9/13/2023
DATE

ARLENE P. BLUTH, J.S.C.

CHECK ONE:	X	CASE DISPOSED			NON-FINAL DISPOSITION		
		GRANTED		DENIED	X	GRANTED IN PART		OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER		
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN				FIDUCIARY APPOINTMENT		REFERENCE