SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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In the Matter of the Application of SANDRA SCHULTE, as Co-Trustee with Fiduciary Trust Company International of the Marital Trust Created for the Benefit of Sandra Schulte under Article V of the Trust Agreement dated April 8, 2002, as restated and amended by

DAVID A. SCHULTE, JR., deceased,
as Settlor,

for an Order Compelling the Estate of David A. Schulte, Jr., and 1125 Park Avenue Corporation to Distribute Certain Assets and for Other Relief.

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DECISION and ORDER

File No.: 2005-4582/C

M E L L A, S.:

Papers Considered	Numbered
Notice of Motion, dated October 7, 2011, to Dismiss Pursuant to CPLR 3211(a)(1), 3211(a)(7) and 3016(b), with Affidavit, dated October 5, 2011, of Elliot Meisel, Esq., and Affidavit, dated October 6, 2011, attaching Exhibits A through F	1, 2, 3
Memorandum of Law, dated October 7, 2011, in Support of Motion to Dismiss	4
Memorandum of Law, filed November 9, 2011, in Opposition, with Affidavit, Dated October 31, 2011, of Sandra Schulte, attaching Exhibit A	5, 6
Reply Memorandum of Law, Dated November 18, 2011, in Support	7
Stipulation, So-Ordered September 28, 2015, Attaching Amended Answer and Cross-Claims and Reply to Cross-Claims	8, 9, 10

Sandra Schulte (Sandra), as co-trustee of an inter vivos trust established by David Schulte, Jr. (David) (the Trust),[1] has petitioned[2] for injunctive relief against 1125 Park Avenue Corporation (1125 Park) and against Holly S. Ellison as executor of David's estate (the Executor).[3] The order that Sandra seeks as a trustee would compel 1125 Park to approve the

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[1]Sandra's corporate co-trustee has been joined in this proceeding. It has neither challenged her authority to act alone in commencing and prosecuting this litigation on behalf of the Trust nor objected to the relief that she seeks.

[2]References to pleadings are intended to relate to those pleadings as amended.

[3]The Executor is David's daughter from an earlier marriage.

Trust's application for transfer of David's interests in an apartment (Penthouse C) now owned by the Executor as an 1125 Park shareholder and Lessee and would compel the Executor in turn to distribute those interests to the Trust pursuant to the terms of David's will. The petition's purported bases for relief are that, by refusing to approve such transfer, 1125 Park has violated its obligations as Lessor under the Proprietary Lease appurtenant to Penthouse C and that, by failing to effectuate the transfer, the Executor has violated her obligation as fiduciary to carry out the terms of David's will.

The Executor's answer alleges that she has done all she could to support the Trust's application for transfer of David's interests in Penthouse C. In addition to serving as a responsive pleading, the answer contains a cross-claim against 1125 Park, alleging bad faith and in substance echoing the petition's request that 1125 Park be ordered to approve the proposed transfer to the Trust. In lieu of filing a responsive pleading of its own, 1125 Park has moved for dismissal of both the petition and the cross-claim under sections 3211(a) and 3016(b) of the CPLR.[4]

The underlying facts are as follows. David purchased his interests in Penthouse C in October 1978, signing the Proprietary Lease not only as Lessee, but also, on behalf of the Lessor as then President of the Board of 1125 Park. To the extent now relevant, paragraph SIXTH of Article II of the Proprietary Lease (Paragraph SIXTH) provides that,

> the Lessee shall not assign this lease, or any interest therein, and no such assignment shall take effect as against the Lessor for any purpose, unless and until all of the following requirements have been

[4]By stipulation so ordered by this court on September 28, 2015, the parties agreed that 1125 Park's motion to dismiss would be deemed to seek dismissal of the cross-claim. The parties further agreed that the court would determine the motion to dismiss the cross-claim based on the papers previously submitted in connection with the motion to dismiss the petition.

complied with and satisfied:

. . .

> A written consent to such assignment, authorized by ... the Board of Directors . . . must be delivered to the Lessor. In the event the Lessee should die during the term of this lease, then the [authorized persons] shall not unreasonably withhold the consent provided for in this paragraph to any assignment or transfer of the stock and the lease which the Lessee may make in the Lessee's last will and testament . . . to a financially responsible member of the Lessee's immediate family . . . .
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> No executor, administrator, personal representative or successor of the Lessee . . . shall be entitled to assign this lease . . . except upon compliance with the requirements of this paragraph SIXTH. The character of and restriction upon . . . assignment of this lease, as hereinbefore expressed, restricted and limited, are an especial consideration and inducement for the granting of this lease by the Lessor to the Lessee . . . ."

The Trust was created by David for Sandra's lifetime benefit, with the remainder left to his descendants, by a March 17, 2005 amendment to Article V of a revocable instrument dated April 8, 2002, shortly before Sandra became David's wife and within a year of the date he died. As then amended, the instrument expressly contemplated that, if David and Sandra were married by the time of David's death, David's interests in Penthouse C would be transferred to the Trust and the trustees would retain those interests for Sandra's residential use so long as she paid certain expenses specified in the couple's prenuptial agreement. As it happens, no transfer of David's interests in Penthouse C occurred before his death on November 13, 2005. Instead, those interests passed under his will as part of his residuary estate, which he bequeathed to the revocable trust he had created on April 8, 2002.

As a trustee, Sandra claims that, under the foregoing provisions of Paragraph SIXTH, 1125 Park cannot "unreasonably withhold consent" to the Executor's proposed transfer of

Penthouse C to the Trust. Her petition alleges that the Board has nevertheless violated that proscription in order to favor one of its members, who wishes to acquire Penthouse C for herself. Accordingly, the petition avers that 1125 Park is in "violation of the Co-op Board's obligations" under the Proprietary Lease. In her cross-claim, the Executor for her own part alleges that the Board has acted in bad faith by refusing to approve the proposed transfer without a "reason," and she avers that such bad faith is "demonstrated" by the fact that one of the members of the Board has expressed interest in purchasing Penthouse C, which adjoins that individual's own apartment.

According to its notice of motion, 1125 Park seeks dismissal of both the petition and the cross-claim on the theories that neither states a ground for relief (CPLR 3211[a][7], that documentary evidence establishes its defense (CPLR 3211[a][1]), and that, in any event, neither the petition nor the cross-claim satisfies the pleading particularity requirement applicable to breach of fiduciary duty claims (CPLR 3016[b]).

Movant's threshold argument for dismissal of the trustee's petition under CPLR 3211[a][7] is that the trustee has no standing to seek relief against movant, since the Trust is not a shareholder of 1125 Park at this juncture and therefore cannot claim to be owed a fiduciary duty by the Board (*see, e.g.*, *Woo v Irving Tenants Corp.*, 276 AD2d 380 [1st Dept 2000]; *Levine v Yokell*, 258 AD2d 296 [1st Dept 1999]; *Sims v Darwood Mgt.*, 147 AD2d 373 [1st Dept 1989]). The trustee for her part raises several arguments in support of her claim to standing, all of which in essence propose that the consent requirement contained in the instruments governing 1125 Park does not prevent the Trust from having present rights against 1125 Park.

There is, for one, the trustee's suggestion that the consent requirement at issue constitutes an impermissible restraint on transfer. But such a proposition as it relates to cooperative

corporations was laid to rest long ago (*see Chemical Bank v 635 Park Avenue Corp.*, 155 Misc 2d 433 [Sup Ct, New York County 1992] *and cases cited therein*). As the Court of Appeals has noted, "there is no reason why the owners of [a] co-operative apartment house [cannot] decide for themselves with whom they wish to share their elevators, their common halls and facilities, their stockholders' meetings, their management problems and responsibilities and their homes" (*Weisner v 791 Park Avenue Corp.*, 6 NY2d 426, 434 [1959]).

Then there is the trustee's argument that David was free, at least with respect to his shares, from the clear restrictions on transfer to which he had expressly agreed when he purchased his interests in Penthouse C, so long as the transfer was made by dispositive bequest in his will. But, ironically, the precedent upon which the trustee chiefly depends in this connection, *Matter of Katz*, 142 Misc 2d 1073 (Sur Ct, NY County 1989), did not involve a testamentary disposition, and itself relied on decisions that, when closely read, suggest the absence of any such principle (*see Matter of Swatzburg v Swatzburg*, 137 Misc 2d 1042 [Sup Ct, NY County 1987] [owner of interests in a cooperative apartment was bound by restriction on transfer imposed by proprietary lease, by-laws, and stock certificate]; *Matter of Lacaille*, 44 Misc 2d 370, 377 [Sup Ct, NY County 1964] ["an assignment [of cooperative shares and lease] could not effectively be made without the consent of the . . . Corporation, as so provided by the terms of the lease which were expressly incorporated in the stock certificate"]; *cf. Matter of Blakeman*, 518 F Supp 1095 [EDNY 1981] [bequest of interest in closed corporation not subject to restriction on transfer only if governing corporate instruments contained no such restriction]). Indeed, such precedents point to the conclusion that, given the restrictions on transfer of David's interest under the Proprietary Lease, the most that he could bequeath to the Trust in relation to Penthouse C was the right to receive that property in kind if the Board consented or, failing that, the right to receive from the

Executor the proceeds of sale of that property to a purchaser acceptable to the Board[5] (*see Joint Queensview Housing Enterprise v Balogh*, 174 AD2d 605 [2d Dept 1991]; *Matter of Chapman v 2 King St. Apts. Corp.*, 8 Misc 3d 1026[A] [Sup Ct, NY County 2005]). Stated somewhat differently, the court concludes that, absent the Board's consent, David could no more freely give an enforceable interest in Penthouse C, in light of the restrictions in the Proprietary Lease, to a gratuitous transferee at death such as the Trust than he could freely give such an interest to a transferee for value under a contract of sale (*see Woo v Irving Tenants Corp.*, 276 AD2d 380 [1st Dept 2000]; *Pober v Columbia 160 Apts. Corp.*, 266 AD2d 6 [1st Dept 1999]; *GSG Holdings v Multi Boro Realty Corp.*, 240 AD2d 159 [1st Dept 1997]; *cf. Matter of Spaziani*, 125 Misc 2d 901, 903 [Sur Ct, Jefferson County 1984]).

To be sure, a consent requirement cannot prevent involuntary transfers by "operation of law" – *i.e.*, involuntary transfers to a purchaser for value upon levy of a debtor's interest (*see Hochman v 35 Park W. Corp.*, 293 AD2d 650 [2d Dept 2002]) or to the personal representative of the estate of a deceased cooperative shareholder upon his death (*see House v Lalor*, 119 Misc 2d 193, 196 [Sup Ct, NY County 1983]). But the Executor's proposed distribution of decedent's interests in Penthouse C to the Trust does not constitute one or the other kind of operation-of-law transfer, and it is therefore subject to the same preconditions to transfer as were binding against David during his lifetime (*see LI Equity Network, LLC v Village in the Woods Owners Corp.*, 79 AD3d 26 [2d Dept 2010]; *Cavanagh v 133-22nd St. Jackson Heights*, 245 AD2d 481 [2d Dept 1997]; *Joint Queensview Hous. Enter. v Balogh*, 174 AD2d 605 [2d Dept 1991]; *but see Matter of Katz, supra*). As the Second Department has observed, "while the . . . board of directors has

[5]Reference to the latter right assumes that there is nothing in the will or trust instrument indicating a contrary intent on decedent's part as testator and grantor.

broad decision-making authority, it cannot act arbitrarily, as it . . . must act in good faith. Consequently, there is no reason to create a special rule which would, in effect, exempt an executor from the restrictions which apply to other holders of proprietary leases" (*Cavanagh*, 245 AD2d at 482 [internal citation omitted]).

Nevertheless, the court is aware that the Trust might be deemed to have standing to seek relief with respect to Penthouse C as a third-party beneficiary under the Proprietary Lease (*see Matter of Chapman*, 8 Misc 3d 1026[A] [Sup Ct, New York County 2005] [where parties to Lease understood provision was to benefit family members and such benefit could arise after tenant's demise, parties to lease "must be presumed to have contemplated that [the provision] would be enforceable by the tenant's estate or heir"]). However, the Trust can lay claim to standing as a third-party beneficiary in this case only if it is among the persons accorded a favored status under the above-quoted provisions of Paragraph SIXTH. Thus, as it happens, the threshold issue as to the Trust's standing as against 1125 Park overlaps with a central question on the merits of this motion: whether the phrase "immediate family" as it appears in Paragraph SIXTH should be read broadly enough to include a trust in which the Lessee's immediate family members have beneficial interests.

At least three considerations militate against such a broad reading.

First, as a basic principle of law, a trust is a separate legal person, distinguishable from the persons who have a beneficial stake in it. It therefore should not be lightly presumed that a legal instrument such as the Proprietary Lease would have ignored the distinction between such persons (*cf. Genger v Genger*, 121 AD3d 270, 280 [1st Dept 2014]). Indeed, David clearly depended upon that distinction when, instead of leaving his interests in Penthouse C to Sandra outright or to his daughter subject to a legal life estate in Sandra, he left those interests to the

Trust. Moreover, the construction argument offered by the trustee in this connection does not have logic to commend it: since the term "trust" is not normally subsumed within the phrase "immediate family," the trustee cannot argue that the phrase "immediate family" as used in Paragraph SIXTH must be read to include the term "trust" because that term was not expressly excluded from the phrase.

Second, if the Lessee and Lessor had intended Paragraph SIXTH to favor not only members of the Lessee's "immediate family," but also, a trust for the benefit of those individuals, that intention could have very easily been expressed (*see, e.g., 1165 Fifth Ave. Corp. v Alger*, 288 NY 67 [1942]) – but it was not.

Third, the inherent nature of a trust – the split between fiduciary authority and beneficial interests, not to mention the possible conflict between or among the beneficiaries themselves -- may make dealing with a trust materially more complicated than dealing with an individual owner (*see, e.g., Matter of Matineo*, 16 Misc 3d 1112[A] [Sur Ct, Nassau County 2007]). Thus, the practical difference between a trust, on the one hand, and an individual, on the other hand, cannot be presumed to have been so immaterial to 1125 Park as Lessor that it would have intended the term "trust" to fall within the term "immediate family member" for purposes of Paragraph SIXTH.

In view of the foregoing considerations, the court concludes that the Trust is not within the favored group of persons provided for by Paragraph SIXTH and that the trustee therefore did not have standing to petition against 1125 Park on the ground that the Lessor had violated its obligations under the proprietary lease relying on the third-party-beneficiary theory of the *Chapman* decision. Accordingly, the trustee's petition is dismissed to the extent that it seeks relief against 1125 Park.

As to the Executor's cross-claim, however, it remains to be determined whether movant has established at least one of the three bases for dismissal that are asserted in the motion now before the court.

To the extent that movant would have the court dismiss the Executor's cross-claim pursuant to CPLR 3211(a)(7) on the ground that she too lacks standing, such invitation need not detain us long. Despite the general rule that ordinarily "a corporation does not owe fiduciary duties to its . . . shareholders" (*Hyman v The New York Stock Exchange*, 46 AD3d 335, 337 [1st Dept 2007]; *see Fletcher v The Dakota*, 99 AD3d 43 [1st Dept 2012]), there can be little doubt that fiduciary duties run to shareholders from the board of a cooperative corporation to act solely in their best interest (*Ackerman v 305 E. 40th Owners Corp.*, 189 AD2d 665 [1st Dept 1993]). Thus, the Board's decision to deny consent to the proposed transfer clearly is subject to the breach-of-fiduciary-duty challenge raised by the cross-claim (*Stowe v 19 East 88th Street*, 257 AD2d 355 [1st Dept 1999], citing *Demas v 325 West End Ave. Corp.*, 127 AD2d 476, 478 [1st Dept 1987]).

Turning now to the part of the motion that invokes section 3211(a)(1), the applicable standard is clear. Documentation can eliminate the issues raised against a respondent only if the document or documents in question "utterly refute[ ] [petitioner's] factual allegations, conclusively establishing a defense as a matter of law" (*Goshen v Mutual Life Ins. Co. of New York*, 98 NY2d 314, 326 [2002]). In this regard, according to movant, the provisions of Paragraph SIXTH establish that the Board was free to withhold its consent to the proposed transfer under the business judgment rule and the Board's decision to do so passes muster under that rule.

Where the business judgment rule applies, it allows decision-making to proceed without

judicial second-guessing so long as the decision in question is not a product of bad faith, such as self-dealing or unlawful discrimination (*DeSoignies v Cornasesk House Tenants' Corp.*, 21 AD3d 715 [1st Dept 2005]). Thus, absent bad faith, "the board of directors of a residential cooperative may generally withhold its approval of a proposed [transferee] for any reason or for no reason at all . . . ." (*Matter of Castleman*, NYLJ, Oct 2, 1997, at 4, col 6 [Sur Ct, Westchester County]). Moreover, it is well established that the business judgment rule applies to the decisions of a cooperative corporation where the governing corporate instruments do not supersede the rule with a standard that is more demanding upon the corporate decision-makers (*Levandusky v One Fifth Ave. Apt. Corp.*, 75 NY2d 530 [1990]). As has already been discussed, the standard that Paragraph SIXTH allows to a very narrow category of individuals (more favorable to them, more stringent from the corporation's perspective) does not apply to a proposed transfer to the Trust. Accordingly, movant is right when it contends that the business judgment rule applies here.

But such determination does not conclude the matter. As noted above, the cross-claim is one for breach of fiduciary duty on the part of 1125 Park, the Executor alleging that the Board has withheld its consent to transfer of Penthouse C to the Trust in order to favor a specified member of the Board who has expressed an intention to acquire the apartment for herself. Simply put, the documentation submitted by movant obviously cannot speak to, much less determine, whether the discretion accorded to the Board by the governing instruments (albeit very broad) was exercised duly or, instead, was used in a way that violated the duty of the Board to act in good faith vis-a-vis its shareholders (*Barbour v Knecht*, 296 AD2d 218, 224 [1st Dept 2002] ["only the board's good faith is at issue. . . . A showing of unequal treatment is sufficient"]; *Bryan v West 81 Street Owners Corp.*, 186 AD2d 514, 515 [1st Dept 1992]).

Finally, such a cross-claim does not fall short of the pleading particularity requirement of section 3016(b) of the CPLR. As the First Department has recognized, the "special provisions [of section 3016(b)] constitute no more than a directive that the 'transactions and occurrences' constituting the 'wrong' shall be pleaded in sufficient 'detail' to give adequate notice thereof" (*Foley v D'Agostino*, 21 AD2d 60, 64 [1st Dept 1964]). The challenged pleading in this case identifies the particular wrong complained of – the violation of the corporate directors' duty to the shareholders to exercise their authority disinterestedly (see *Foley v D'Agostino*, *supra*, 21 Ad2d at 67). The pleading also identifies the injury allegedly caused, i.e, interference with the Executor's responsibility to distribute a bequest in accordance with her decedent's preference that, following his death, his interests in Penthouse C be distributed in kind to the Trust, rather than sold to a third party and the sale proceeds distributed to the Trust. It is therefore concluded that the cross-claim satisfies the particularity requirement under section 3016(b) (*compare DeRaffele v 210-220-230 Owners Corp.*, 33 AD3d 752, 752-53 [2d Dept 2006] [plaintiff, claiming ownership of unsold shares in a cooperative apartment corporation, failed to allege sufficient specific facts of board's bad faith "or that any damages were attributable to their actions"]; *Hochman v 35 Park W. Corp.*, 293 AD2d 650 [2d Dept 2002] [complaint against co-op board dismissed where it made only "conclusory" reference to board's "bad faith"]).

For the reasons stated above, the motion to dismiss is granted with respect to the trustee's petition as against 1125 Park, but it is denied with respect to the Executor's cross-claim.

This decision constitutes the order of the court.

Dated: April 14, 2016

SURROGATE