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New Liability Ruling: How Does It Affect Boards?

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New Liability Ruling: How Does It Affect Boards?

Is an individual board member exempt from liability if acting in his or her capacity as a board member? That was one of the many questions in *Fletcher v. The Dakota Inc.*

Alphonse “Buddy” Fletcher Jr. was a resident of The Dakota, a co-op apartment house at 1 West 72nd Street in Manhattan. Fletcher, an African-American, alleged that the co-op and two of its directors discriminated against him because of his race when the board refused to approve his purchase of an apartment adjacent to the one he already owned, for the purpose of combining the two. Fletcher claimed that the co-op and two individual board members retaliated against him because he sought to protect the rights of minority and Jewish shareholders and applicants. He also claimed he was defamed by the defendants.

Before it addressed this particular case, the appellate court discussed potential individual director liability. In a prior case, *Pelton v. 77 Park Avenue Condominium*, the same court that was deciding this motion discussed individual director liability. Here, the defendants argued that claims should have been dismissed against two board members because the complaint failed to show that they took action separate and distinct from the actions they took as board members – in other words, that Fletcher failed to allege that they had engaged in any independent tort-related conduct.

The court first reviewed the state human rights law (a discrimination statute), which prohibits discrimination by an owner, “lessee, sub-lessee, assignee, or managing agent of, or other person having the right to sell, rent, or lease a housing accommodation ... or any agent or employee thereof.” The city human rights law similarly provided for individual liability. The court noted that there were no exceptions in either statute for directors of co-ops or directors of any other corporation.

The court then discussed the “Business Judgment Rule,” as enunciated by New York’s highest court – the Court of Appeals – in *Levandusky v. One Fifth Avenue Corporation*. The *Levandusky* court found that the rule was the proper standard of judicial review so that the court would not review actions taken by corporate directors if taken in good faith, in the exercise of honest judgment, and in the lawful furtherance of corporate purposes. In *Levandusky* and a later case, the court cautioned that the rule should not serve as a rubber stamp for board actions. Accordingly, the *Fletcher* court explained, arbitrary, malicious, or discriminatory acts were not protected.

The court found that there was nothing in these Court of Appeals cases to suggest that there was a safe harbor for directors. There was also no principle of corporate law that a director would be liable only if he or she committed a tort independent of the tort committed by the corporation itself. Indeed, the court explained that it had long been the law that a corporate officer who participated in a tort could be individually liable.

In addition to reviewing case law, the court cited a leading treatise in corporate law. Directors could be personally liable to third persons if they participated in, directed, controlled, approved, or ratified the decision that led to a plaintiff’s injuries.

The court then discussed its 2006 decision in *Pelton* and determined that it had misapplied the dictates of a 1978 Court of Appeals case. The court noted that it had improperly conflated the concepts for breach of contract (where an individual director would not be liable) and commission of a tort (where an individual director may be liable).

With respect to discrimination claims, the Court of Appeals recently determined that the city’s discrimination statutes should be construed broadly in favor of plaintiffs who claim discrimination. Accordingly, the court did not dismiss discrimination claims against the individual board member.

The court next discussed Fletcher’s claim of retaliation by the co-op and a board member. The New York State discrimination statute stated that it was unlawful to retaliate against someone because he or she opposed any practice of discrimination. The court explained that to make out a claim for retaliation under state law, the complaint had to allege that (i) Fletcher opposed conduct protected by the statute, i.e., discrimination; (ii) the defendants knew about Fletcher’s conduct; (iii) Fletcher was subject to an adverse action; and (iv) there was a causal connection between Fletcher’s actions and the adverse action.

The city discrimination laws were similar – one could not retaliate against someone because the person opposed discriminatory practices. With respect to the city law, however, the retaliation need not have resulted in an ultimate action or in a materially adverse change but must be reasonably likely to deter a person from acting.

The court interpreted the city law, as it was required to, “broadly in favor of discrimination plaintiffs” to the extent such a construction was “reasonably possible.” The court relied on an earlier case, which explained that when reviewing a retaliation claim, the court had to have a “keen sense” of the realities and that the “chilling effect” of conduct was dependent upon the surrounding circumstances. To make out a claim for retaliation under the city laws, Fletcher had to allege that (i) Fletcher opposed discriminatory practices; (ii) the defendants took an action that disadvantaged Fletcher; and (iii) a causal connection existed between Fletcher’s actions and the adverse action.

In the complaint, Fletcher alleged that he began to oppose conduct that he believed was discriminatory after he was elected president of the co-op board in May 2007. In September of that year, Fletcher complained to one of the individual defendants that another board member had referred to certain applicants as the “Jewish mafia.” Those applicants were initially rejected, although Fletcher and one other voted to approve them. Fletcher claimed that the board member asked him not to raise the issue again, but that Fletcher urged the board to meet the applicants and,

upon doing so, it approved the application. Based upon Fletcher's allegations of discussions about the Jewish applicants' ethnicity and religion, the first element of the retaliation claim had been established.

Fletcher alleged that the defendants denied him the benefit of a specific building policy concerning his application to purchase another apartment, denied him an impartial and unbiased review of his financial disclosures, and recommended rejection of his application. Thus, Fletcher alleged sufficient claims to establish that he was subjected to an adverse action.

Because an individual director had knowledge of Fletcher's actions, his knowledge was imputed to the co-op. The court addressed whether the time lag between Fletcher's challenge to the board's initial rejection of the Jewish applicants and the board's alleged retaliation was an issue. It held that the approximate three-year gap did not defeat the claim; Fletcher's application to purchase another apartment was the first opportunity the board had to retaliate.

As to another director who was individually named, he did not become a board member until after September 2007, and the retaliation claims were dismissed against him on the theory that he did not know about Fletcher's actions in September 2007. If it was determined that he did know, Fletcher had the right to ask the court to reinstate the claim. As to the co-op, the court refused to dismiss Fletcher's claims as they related to the Jewish applicants.

The complaint also alleged that Fletcher "made it clear" to the board that its jokes about another shareholder's bathroom repairs were inappropriate. However, even though the shareholder was African-American, there was no claim that Fletcher had made reference to her race. Accordingly, claims of retaliation based on statements made about this shareholder were dismissed without prejudice so that if discovery showed that the defendants knew Fletcher was opposing discrimination when discussing her, Fletcher could ask that the claim be reinstated.

The court then discussed that, because The Dakota is a corporation, it does not owe a fiduciary duty to its shareholders. Claims based on fiduciary duty were dismissed against The Dakota with prejudice so that they cannot be re-pleaded. As to the individuals, however, the fiduciary duty claims were dismissed without prejudice, so that if discovery showed additional information, Fletcher could request that they be reinstated.

The court then turned its attention to the defamation claims. To the extent any defamation claims were based on papers submitted in the lawsuit, they were dismissed because the statements were protected communications made in the context of a lawsuit.

As to other statements, the assertion was that the defendants "knowingly and maliciously spread false statements and rumors to third parties, including the media, concerning Fletcher's financial condition." The court acknowledged that the complaint set forth specific allegedly defamatory statements verbatim. While the co-op claimed that the statements were the subject of a "qualified privilege," presumably because they were made only to shareholders at The Dakota (the decision does not specify), the privilege can be defeated by a claim that the statements were made with malice, which Fletcher alleged. As to the individuals, the defamation claim was not dismissed for one who Fletcher alleged had made defamatory statements.

The court next turned to the claim that the co-op tortiously interfered with Fletcher's contract to purchase the apartment. The court stated that a cause of action could be present and did not dismiss the co-op's claim. It did, however, dismiss the claim against one individual board member as there was no evidence that he had committed an independent tortious act outside his role as a board member. **Comment**

: While this decision is being reported by some as a departure from prior decisions, and it does specifically "overrule" the Pelton v. 77 Park Avenue Condominium decision in which it was found that board members were not liable for

discrimination, it is our belief that in many respects the appellate court is merely reiterating long-standing corporate law, i.e., that in the context of a tort or a claim of discrimination (and not contract claims), if a board member acts in furtherance of that tort, he or she may be liable. This is consistent with such well-known cases as the Broome v. Biondi (Beekman Hill Apartments) matter, where board members were held personally liable for refusing to allow a mixed-race couple to sublet based upon actions taken by board members, who, according to testimony, took the husband's African-American race into consideration when rejecting the couple.

Indeed, the court is clear that board members will not be responsible for the co-op's breach of contract. What is of concern is whether board members may be held liable for torts committed by their co-op, such as negligence. While certain provisions of the decision would lead one to believe that this may be the case, the court specifically dismissed the claim of tortious interference with contract against a board member, stating that "the complaint does not allege that [the board member] committed independent tortious conduct outside of his role as a board member." We believe these aspects of the case will be reviewed and interpreted by the courts in future decisions.

As to the defamation claims, while there is a qualified privilege that permits board members and shareholders to discuss information about their building without being subject to a claim for defamation, that privilege will not apply in the event there is a claim of "malice," i.e., that the statement was made with knowledge that it was false or with reckless disregard of whether it was true. In this case, it appears that certain statements were alleged to have been made to the press, and were not subject to the privilege in any event. Other statements made to board members and shareholders were alleged to have been made with malice and therefore were not dismissed.

We note that the motion to dismiss the claims was made at the early stage of the case so that discovery may shed a different light on certain allegations and defenses.

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