

The Many Moving Parts of a Foreclosure

BY DALE J. DEGENSHEIN

IN LOUIS ZAZZARINO vs. 13-21 East 22nd Street Residence Corp., a shareholder defaulted on a loan made by her bank. The bank held a non-judicial auction of the shares, as was its right under its loan documents, and Zazzarino was the successful bidder. Any final sale, however, was subject to the board's approval, and the board decided not to approve Zazzarino. Although the decision doesn't discuss it, it seems that Zazzarino was an investor who purchased and flipped apartments. He would not make the apartment his residence, and the board did not want an investor purchasing an apartment.

The original shareholder wound up paying the lender what was owed and was able to keep the apartment. Zazzarino sued. Among other things, he pointed to a provision in the proprietary lease: "If purchase by the Lessee [the shareholder] of the shares allocated to the apartment was financed by a loan made by a bank . . . and a default . . . shall have occurred under the terms of the security agreement, an individual designated by the secured party [the lender] . . . shall become entitled to become the owner of the shares [subject to] the consent of the Lessor's then managing agent, which shall not be unreasonably withheld."

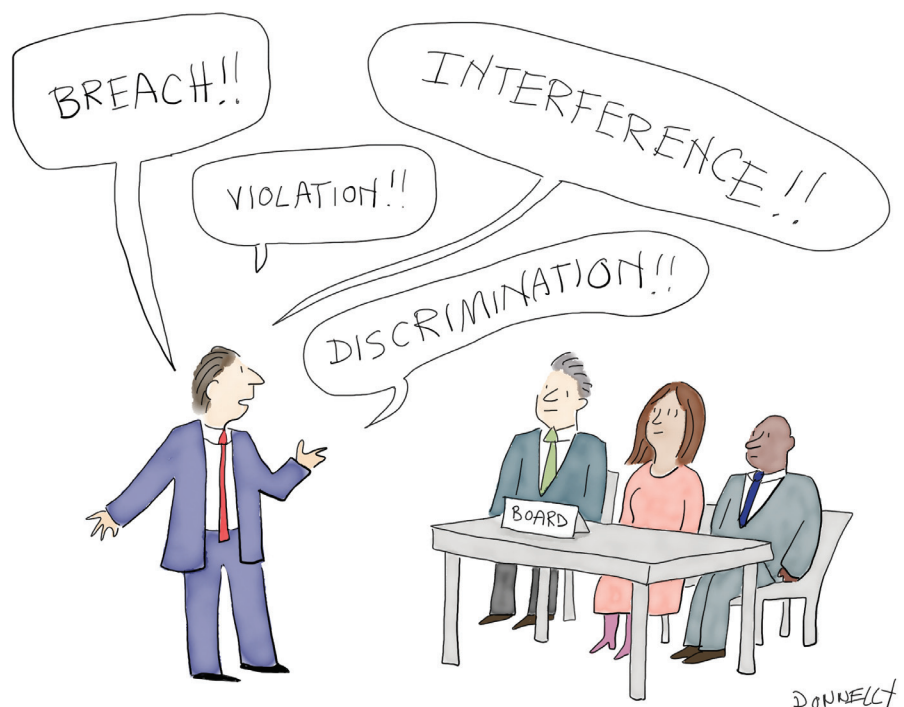
Thus, Zazzarino argued, whoever purchased at auction would be permitted to purchase the shares without board approval but with approval by the managing agent, which could not be "unreasonably withheld." Zazzarino made a number of other arguments, including that the board breached its contract with

him; that the board interfered with his contract with the lender when it refused to allow him to purchase; that the board had a duty to act in good faith and failed to do so; that the board breached its fiduciary duty to Zazzarino by engaging in fraud and self-dealing; and that the board discriminated against him because he is of Italian-American ancestry.

The court said that Zazzarino was, at best, a potential purchaser. The loan that was foreclosed was a home-equity loan taken years after the shareholder bought the apartment – not a loan used to finance the purchase of the apartment. Therefore, it was not subject to the lease provision upon which Zazzarino relied.

The court also found that there was

no contractual obligation on the part of the co-op and thus no contract for the co-op to breach. The board's duty to act in good faith is also premised on the existence of a contract. As to interference with Zazzarino's contract with the lender, the board had the absolute right to accept or reject Zazzarino's application. Therefore there was no interference; the board was merely exercising a right. As to breach of fiduciary duty, there was no fiduciary relationship. As to discrimination, Zazzarino didn't allege any facts that showed even an inference of discrimination based upon his national origin. In fact, there was no evidence that the board was aware he was Italian-American. The court dismissed the complaint against the co-op.



Reading the Ruling

When faced with a foreclosure, it's important for boards to review their documents to determine the corporation's responsibilities to both the shareholder and the potential purchaser. As there is likely a recognition agreement (a contract entered into by the shareholder, co-op, and lender), the board should also review its responsibilities to the lender. Boards should

be proactive in dealing with the lender to make sure, among other things, that the terms of sale in the foreclosure include a provision that any purchaser at auction is subject to board approval. As an aside, we note that courts have held that where a provision of a lease requires action by the managing agent, as opposed to the board, the managing agent may take the board's position into consideration. ■

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