SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. JOEL M. COHEN** **PART** IAS MOTION 3EFM

Justice

----------X

WINNIE TSUI, GINYEE CHU, DARREN JACKSON, DIMPLE BHATT, TANVA NANTAKWANG, LILA HEYMANN, LIN CHEUNG, JEANNIE CHEUNG, KIM LAM, SALMA ABDELNOUR, JING TUN, CHONG TUN, HAROLD KIM, JESSICA ROSENRAICH, MARIE-HELENE ATTWOOD, ALL DERIVATIVELY ON BEHALF OF ALL UNIT OWNERS OF THE EMPIRE CONDOMINIUM

Plaintiffs,

- v -

KATHERINE CHOU, ROBERT CHOU, RITA CHOU, and CHOU MANAGEMENT CO. INC.,

Defendants

and

THE BOARD OF MANAGERS OF EMPIRE CONDOMINIUM, IRENE TAM, YUH CHEN,

Necessary-Party Defendants.

----------X

INDEX NO. 652840/2013

DECISION AFTER NON-JURY TRIAL

This is a long-running dispute among unit owners in the Empire Condominium ("Empire").

Several unit owners ("Plaintiffs") brought this derivative action on behalf of Empire against the original Sponsor (and multi-unit owner) of Empire, Katherine Chou ("Katherine"), her husband Robert Chou ("Robert"), the couple's daughter Rita Chou ("Rita"), and Robert's wholly owned management company, Chou Management Co., Inc. ("CM") (collectively, "Defendants"). Plaintiffs claim that Katherine, Robert, and Rita have improperly dominated

Empire's Board of Managers (the "Board"),[1] are using their influence to maintain control of the Board, and engaged in an inappropriate self-dealing transaction by hiring CM to manage Empire without recusing themselves or providing full disclosure of relevant background facts to the Board. Plaintiffs claim that Defendants' alleged actions are in breach of Empire's Offering Plan (NYSCEF Doc. No. 270 [the "Plan"]), By-Laws (NYSCEF Doc. No. 279), and their fiduciary duties to Empire's condominium owners ("Unit Owners"). In response, Defendants claim that they have not wrongfully entrenched themselves as members of the Board, that they fully disclosed all relevant background facts before the Board retained CM, and that they are not individually liable for Plaintiffs' alleged grievances.

In a summary judgment decision prior to trial, the Court determined that Katherine breached the Plan when she did not obtain an amendment reflecting her continued ownership of several Units that she decided not to sell (*see* Plan at p. 63). Further, Katherine improperly continued to vote for a majority of Board seats despite a provision of the By-Laws that prohibited her from doing so (By-Laws at Art. 3, § 1).

After a three-day bench trial, the Court finds with respect to the remaining claims that:

1. The Board (dominated by Katherine, Robert, and Rita) breached the Plan and By-Laws by disregarding provisions governing the election of Managers to the Board, thereby permitting Katherine, Robert, and Rita to collectively control 50% of the Board without the required approval of the Unit Owners;
2. Katherine, Robert, and Rita breached their fiduciary duties by failing to recuse themselves from the Board's decisions to retain and renew CM as Empire's management company;

[1] The Board is a necessary-party defendant in this case.

3. The Court finds that certain non-monetary remedies with respect to Board elections and selection of a management company, described herein, are necessary and appropriate to address the foregoing breaches of contract and fiduciary duty;
4. Plaintiffs failed to prove that they or Empire suffered any monetary damage from Defendants' conduct (including the hiring of CM);
5. Within 90 days after a "Reset Election," described *infra*, the Board will hire independent certified public accountants to produce annual verified financial statements to be distributed to Unit Owners prior to each Annual Unit Owners Meeting; and
6. Plaintiffs are entitled to Attorneys' Fees per B.C.L. § 626(e) with respect to the trial of this matter, including pre-trial and post-trial briefing.

Procedural History

In August 2013, Plaintiffs filed their initial Complaint against Katherine, Robert, and CM seeking declaratory and injunctive relief, as well as monetary damages for claims of trespass, breach of contract, breach of fiduciary duty, the imposition of a constructive trust, and attorneys' fees (NYSCEF Doc. No. 1). On July 7, 2014, this Court (Schweitzer, J.) dismissed Plaintiffs' Amended Complaint (NYSCEF Doc. No. 66).

The First Department reversed that dismissal with respect to all claims other than trespass and constructive trust:

> "The motion court incorrectly determined that plaintiffs' breach of fiduciary duty and breach of contract claims are barred by the business judgment rule. Plaintiffs, suing derivatively on behalf of all unit owners of a condominium, allege in the amended complaint that the Chou defendants breached their fiduciary duties by, among other things, failing to disclose various lawsuits and defendant Robert Chou's criminal record, failing to account for missing monies and receipts, commingling funds, denying access to information and documentation, and improperly renewing defendant Chou Management's management agreement. Plaintiffs also allege that defendant board members improperly

> extended their terms on the board beyond the allowable period under the bylaws. There is nothing in the record to indicate that the board discussed or informed themselves as to these allegations. The board's determination not to pursue these claims was arbitrary and therefore not protected under the business judgment rule. Moreover, even if the board did consider the allegations of improper extension of their terms, any determination on that issue would not be protected under the business judgment rule, as the voting members were clearly self-interested.
>
> There is nothing in the record to indicate that the board discussed or informed themselves as to plaintiffs' breach of contract cause of action, which is based on allegations that, among other things, defendant sponsor breached the offering plan and declaration by refusing to sell condominium units. The board's decision not to pursue these allegations was arbitrary and therefore not entitled to deference under the business judgment rule."

Tsui v Chou, 135 AD3d 597, 597 [1st Dept 2016] [citations omitted].

The parties subsequently engaged in discovery and motion practice for the next few years, including Defendants' successful motion to disqualify Plaintiffs' prior counsel (NYSCEF Doc. No. 101). On August 9, 2019, Plaintiffs amended their pleadings, adding Salma Abdelnour ("Abdelnour") as a plaintiff and Rita as a defendant (NYSCEF Doc. No. 158).

For their breach of fiduciary duty claim, Plaintiffs allege that Defendants failed to disclose material facts to the Board when selecting a management company for Empire. Plaintiffs allege that the Board's eventual hiring of CM was a self-dealing transaction arranged by Defendants (*see* NYSCEF Doc. No. 162 ["Verified Second Amended Complaint"] at ¶¶ 183 – 195). For those alleged breaches, Plaintiffs seek the following relief: (1) a money judgment against Robert and CM consisting of all Empire funds paid to CM or any of Robert's other businesses; (2) rescission of CM's 2017 Management Contract with Empire; (3) a permanent injunction banning members of the Chou family from being Board members or approving any contract with CM; and (4) an award of costs, disbursements, and attorneys' fees (*id*. at ¶ 195).

For their breach of contract claim, Plaintiffs allege that Robert and Katherine breached the Plan by retaining ownership of Units, failing to relinquish control of the Board, and

improperly voting for a majority of the Board (*id*. at ¶¶ 196 – 200). Plaintiffs also allege that Defendants breached the By-Laws by improperly controlling the Board's elections and failing to provide proper annual financial statements to Unit Owners (*id*. at ¶¶ 203 – 206). For their breach of contract claim, Plaintiffs seek the following relief: (1) a permanent injunction banning the Chou family from being Board members or voting for Board positions; (2) a temporary injunction prohibiting the Board from acting on any matters until a new Board is elected; (3) a mandatory injunction requiring a new Board election with varying fixed term lengths for Board members; (4) a declaration that Empire's financial statements need to be verified by independent public accountants; and (5) an award of costs, disbursements, and attorneys' fees (*id*. at ¶ 207).

This Court issued a decision on the parties' competing motions for summary judgment on July 1, 2020 (NYSCEF Doc. No. 243 ["SJ"]). The Court found that Katherine breached the Plan by failing to amend the Plan to reflect her ownership of Units she decided not to sell (*id*. at p. 8) and that she breached the By-Laws by voting to elect a majority of the Board (*id*.). The Court found that Plaintiffs' breach of fiduciary duty and remaining breach of contract claims raised triable issues of fact for trial, and that Plaintiffs' breach of contract claims were not barred by the statute of limitations (*id*. at pp. 5, 9).

A non-jury trial was held with respect to the remaining claims and as to remedies on all claims from November 9 to November 12, 2020.

Evidence Presented at Trial

1. At trial, Plaintiffs presented live testimony from the following witnesses:
    a. Robert (Defendant) (Tr. 6:25 – 43:7).
    b. Katherine (Defendant) (Tr. 44:4 – 49:13).
    c. Abdelnour (Plaintiff) (Tr. 68:7 – 90:21).

d. Winnie Tsui ("Tsui") (Plaintiff) (Tr. 101:18 – 137:3).

e. Lila Heymann ("Heymann") (Plaintiff) (Tr. 145:21 – 166:13).

f. Marie Helene Attwood ("Attwood") (Plaintiff) (Tr. 172:21 – 196:12)

2. Defendants presented live testimony from the following witnesses:

a. Robert (Defendant) (Tr. 204:23 – 213:23).

b. Rita (Defendant) (Tr. 227:2 – 285:2).

3. In addition, this Court admitted roughly 63 exhibits into evidence (NYSCEF Doc. Nos. 270 – 335).

Findings of Fact

Based on its review of the evidence presented at trial, including its evaluation of the credibility of the witnesses who testified during the proceedings, this Court makes the following findings of fact:

Formation of Empire

1. Empire was established in 1986 pursuant to the Plan, converting the building at 259 Elizabeth Street, New York City, New York 10012 (the "Building") into a condominium complex.
2. Katherine is Empire's Sponsor. As Sponsor, Katherine oversaw the initial offering and sales of Empire's Units.
3. As Sponsor, Katherine was "not obligated to offer or sell any of the Units and may, if she chooses and amends [the] Plan to so indicate, withhold one or more Units for future sale" (Plan at p. 63). Katherine currently retains title ownership to four residential Units: 7A, 7B, 7C, and 7D (NYSCEF Doc. No. 262 ["Joint Stipulated Facts"] at ¶ 6). Katherine never amended the Plan to reflect that she withheld one or more units for future sale.

4. In 1989, Katherine sold Unit 1C to Rita (*id*. at ¶ 7).
5. Katherine later sold Units 4B and 4D to her daughters, Rita and Regina Chou, respectively (*id*. at ¶ 8).
6. Katherine also owns the following professional and commercial Units: Professional Unit A, Professional Unit D, Commercial Unit A, and Commercial Unit D (*id*. at ¶ 9).
7. Robert owns Professional Unit C, which was transferred to him by Katherine in 2016.

The Board of Managers

8. Empire's business and affairs are overseen by the Board.
9. Under the By-Laws, the Board is to be comprised of five residential managers (owners of residential Units) and one professional manager (owner of a commercial Unit) elected annually by Unit Owners (By-Laws at Art. 3, § 1).
10. For the first Annual Unit Owners Meeting, one Board member had a fixed term of three years, two Board members had fixed terms of two years, and two Board members had fixed terms of one year (*id*). The professional manager on the Board had an initial fixed term of three years (*id*).
11. After the election of the initial Board, all Board members were to be elected for three-year terms (*id*.).
12. Elections to the Board were to be staggered, with one-third of the Board's terms expiring each year (*id*.).
13. As Sponsor, Katherine was to control the Board until "the sooner to occur of (a) the fifth anniversary of the first closing or (b) the closing of title to 75% of the Units in number and in aggregate Common Interests" (Plan at p. 1, § 1). Katherine was permitted to

designate a majority of the Board members until one of the above conditions was satisfied (By-Laws at Art. 3, § 1).

14. Once the above conditions were satisfied, which they have been, Katherine is not permitted to cast her votes for a majority of the Board (Plan at p. 38). However, Katherine has the right to unilaterally designate one residential member of the Board for as long as she, as Sponsor, owns one or more Units (*id*. at 38).
15. Notwithstanding the above restrictions, Katherine has cast her votes based on all Units she retained for each open Board seat.
16. Katherine has served on the Board throughout Empire's existence (NYSCEF Doc. No. 300 ["Katherine Chou Deposition Excerpts"] at Tr. 24:4-8), having re-designated herself as a Board member as recently as December 4, 2019 (NYSCEF Doc. No. 308 ["Rita Affidavit"] at ¶ 7).
17. Robert began serving on the Board in some capacity starting at least in 2009. Robert testified that he was elected to the Board in 2009, and then reelected in 2010 and 2018 (NYSCEF Doc. No. 334 ["Robert Direct Testimony"] at ¶ 7), but the Court did not find his testimony to be consistent or reliable. Rita recalled that Robert was elected to the Board in 2010, alongside Katherine (NYSCEF Doc. No. 335 ["Rita Direct Testimony"] at ¶ 39 [b]).
18. Robert was not an actual Unit Owner until 2016 (NYSCEF Doc. No. 297 ["Professional Unit C Deed"]), when Katherine transferred title of Professional Unit C to him.
19. At the 2009 Annual Unit Owners Meeting, Robert put his name on the meeting sign-in sheet listing Units he did not own (Professional A, Professional C, Professional D, Commercial A, and Commercial D) (NYSCEF Doc. No. 309 ["2009 Annual Unit

Owners Meeting Minutes"]). Robert did the same at the 2011 Annual Unit Owners Meeting (Tr. 28:15 – 33:24; NYSCEF Doc. No. 311 ["2011 Meeting Minutes"]). Robert testified that he was signing on behalf of his wife and her interests, although Katherine also signed the sign-in sheets listing her separately owned Units.

20. Rita believed that Robert was later *appointed* by Katherine to the Board in 2013 (Tr. 259:13 – 260:22).
21. Since 2010, Robert served on the Board without being subject to an election until 2019 (Rita Direct Testimony at ¶ 39 [g]).
22. In 2009, Rita was elected to the Board. Rita served on the Board without being subject to an election until 2017 (*id*. at ¶ 39 [e]).
23. The Board did not hold elections from 2012 to 2015, purportedly due to disputes among Unit Owners on election procedures and as to whether Katherine was permitted to vote for every Board seat.
24. As of 2019, the last year as to which evidence was presented, the Board members were Katherine, Robert, Rita, Yuh Hu Chen ("Chen"), Irene Tam ("Tam") and Tsui (Joint Stipulated Facts at ¶¶ 11-12).
25. Between 2011 and 2019, Chen was reelected twice, in 2016 and 2018 (Rita Direct Testimony at ¶ 39).
26. Between 2011 and 2019, Tam was reelected twice, in 2016 and 2018 (*id*.).
27. Between 2011 and 2019, Tsui was reelected once, in 2017 (*id*.).
28. Between 2011 and 2019, Rita was reelected once, in 2017 (*id*.).
29. Between 2011 and 2019, Katherine was reelected once, in 2019 (*id*.).
30. Between 2011 and 2019, Robert was reelected once, in 2019 (*id*.).

31. In 2019, Jenny Zou was elected to fill Chen's seat after his resignation.
32. As is clear from the above, elections were not held on a regular basis for each Board seat, as required by the By-Laws. As a result, members of the Chou family have for many years constituted 50% of the Board without being subject to regular elections.
33. Additional facts with respect to irregularities in Board elections are discussed in the Conclusions of Law, *infra*.

Empire's Management Agreement with CM

34. Robert is the sole member and owner of CM.
35. In 2000, the Board contracted with CM to serve as its management company for one year.
36. No evidence was presented at trial as to whether Defendants disclosed to the Board that Robert was not a Unit Owner until 2016.
37. No evidence was presented at trial as to whether Defendants disclosed information about Robert's prior criminal convictions to the Board.
38. CM's contract with Empire automatically renewed every year through 2013.
39. The Board renewed CM's Contract in 2014 and paid CM $24,000 a year through September 2017. The vote was five to one, with only Tsui voting no (Rita Direct Testimony at ¶ 11).
40. The Board renewed CM's Contract in 2017 and paid CM $24,000 a year through October 2020. The vote was five to one, with only Tsui voting no (*id*. at ¶ 12).
41. Despite their direct and indirect financial interests in CM, Katherine, Robert, and Rita failed to recuse themselves from the process of selecting and renewing CM.

42. There was no credible evidence that the Board undertook a process to consider other candidates or to determine whether CM's fees were consistent with market rates.
43. Occasionally, CM has used the services of Leehi Construction, another company owned by Robert, to perform maintenance and repairs at the Building.
44. Robert did not request or receive Board approval to hire Leehi to do work around the Building for all matters costing less than $5,000 (Tr. 213:3 -14).
45. There was no credible evidence that the Board undertook a process to consider other candidates or to determine whether Leehi's fees were consistent with market rates.
46. At trial, Plaintiffs testified about what they perceived to be maintenance issues throughout the building, arguing that CM was unresponsive to Building maintenance concerns. Although Plaintiffs recounted several problems with the Building, including intermittent leaks, loss of hot water, and loss of heat, much of this testimony was based on hearsay and representations allegedly made by tenants to Unit Owners.
47. Plaintiffs' testimony about Building maintenance problems did not establish by a preponderance of evidence that the Board's hiring of CM directly caused Plaintiffs or Empire to experience any specific financial loss. Suggestions that CM's alleged mismanagement depressed the market value of Units were speculative and not supported by credible evidence as to market conditions.

Empire Financial Statements

48. Under the By-Laws, the Board is required to obtain and distribute to Unit owners financial statements "verified by an independent public accountant" (By-Laws at Art. 3, § 1).
49. Since 2014, Schreck & Co. has prepared Empire's financial statements.

50. Robert and Katherine hired Schreck, directing their scope of work, and provided the information Schreck relied on in preparing the reports.
51. In their reports, Schreck stated it performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Schreck stated that it "did not audit or review the financial statements" nor did it "perform any procedures to verify the accuracy or completeness of the information provided by management" (NYSCEF Doc. No. 289 ["Schreck 2015 Statement"] at p. 2; NYSCEF Doc. No. 290 ["Schreck 2016 Statement"] at p. 2).
52. The Board did not, as required, obtain financial statements *verified* by an independent public accountant.

Conclusions of Law

Defendants Breached the Plan & By-Laws By Disregarding Board Election Procedures

To succeed on their Breach of Contract cause of action, Plaintiffs had to prove that an enforceable agreement existed between the parties, Plaintiffs performed in accordance with the agreement, Defendants breached the agreement, and Plaintiffs sustained damages as a direct result of Defendants' breach (*Harris v Seward Park Hous. Corp.*, 79 AD3d 425, 426 [1st Dept 2010]). "Neither party disputes that the Plan and By-Laws are enforceable agreements that set forth the contractual rights and obligations of the parties in this case" (SJ at pp. 8-9).

Plaintiffs proved by a preponderance of the evidence that the Board (dominated by Defendants) failed to follow the required election procedures outlined in the Plan and By-Laws. The Board failed and refused to hold elections for a three-year span. When elections occurred,

the Board listed certain Board seats for elections more than other seats. Katherine, Robert, and Rita had to defend their seats only once from 2011 to 2019.

Moreover, the Board (dominated by Defendants) ignored the contractual parameters and requirements for Board membership. For example, no credible or cohesive evidence indicated precisely how and when Robert was elected to or designated to the Board. In his direct testimony by affidavit, Robert states that he was a Board member "since at least 2009" (Robert Direct Testimony at ¶ 7). Robert testified that after "being voted onto the Board by a majority vote of unit owners in 2009," he was later re-elected by majority vote in 2010 and 2018 (*id.*). However, Robert was *not* a Unit Owner until 2016, so if Unit Owners actually elected him to the Board prior to 2016, Robert's election was improper and in breach of the Plan and By-Laws.

Rita offered a different version of events. In a 2013 Affidavit, Rita states that Robert was "initially appointed to the Board as a sponsor representative and has continued to sit on the Board in that capacity to the date hereof" (NYSCEF Doc. No. 295 ["Rita 2013 Affidavit"] at ¶ 3). During cross-examination at trial, Rita testified that "the By-Laws state that only a Professional unit owner can be a board member representing the professional spaces, and at the time the only professional unit owners I believe was my mother and perhaps one other person, and so for the professional units then my mother designated the seat and allowed my father to run for that seat or to sit in that seat" (Tr. 256:23 – 257:4).

There are two problems with this explanation. First, during trial, Katherine stated that she did not know whether she had the power as Sponsor to designate someone to the Board (Tr. 48:4-7), although Rita previously stated that Katherine re-designated herself as a Board member as recently as December 4, 2019 (Rita Affidavit at ¶ 7). Second, although Katherine's Board designee does not have to be an actual Unit Owner (By-Laws at Art. 3, § 1), Katherine is limited

by the Plan to designating someone for a residential Board seat only, not the professional Board seat (Plan at p. 38).[2] Notably, when Robert signed the sign-in sheets for the 2009 and 2011 Annual meetings, he signed his name next to a listing of commercial and professional units actually owned by Katherine (Tr. 28:15-33:24; 2009 Meeting Minutes; 2011 Meeting Minutes). Although Robert testified that Katherine authorized him to sign for the professional units (Tr. 33:4-12), the sheets do not reflect that he signed into the annual meetings of Unit Owners as a representative, not a Unit Owner.

To explain the discrepancy, Rita testified that she didn't know the "exact semantics" (Tr. 259:2-5), and that it was perhaps a "language issue" in terms of what her parents understood of the By-Laws and whether or not Robert had to be elected (Tr. 261:1-17). However, compliance with Empire's governing documents is not a question of semantics. Regardless of whether Robert was elected, designated, or some combination of both processes, his ascension to the professional Board seat was improper prior to his ownership of Professional Unit C in 2016.

To be sure, there is nothing inherently wrong with members of the same family having a presence on the Board. If the elections are held in accordance with Empire's Plan and By-Laws, the Unit Owners' choices should prevail. The problem here is that mandated procedures were ignored. Robert stood for election when he was not a Unit Owner. Katherine designated Robert

[2] Plaintiffs make an argument in their post-trial brief, unsupported by evidence proffered during trial, that Katherine was only able to designate a Board member during the sales and marketing program. Although Article III, Section 1 of the By-Laws is designed to provide the Sponsor with a controlling vote during Empire's sales and marketing program, the By-Laws do not limit the Sponsor's right of designation to the pendency of that program. Moreover all parts of the agreements must be read as a whole, and "every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose" (*Williams Press v State of NY*, 37 NY2d 434, 440 [1975]). In addition to Article III of the By-Laws, the Plan separately states at page 38 that "for so long as the Sponsor owns one or more Units, Sponsor or its designee" may elect one residential Board member, without referencing any limitation on this right.

to the Professional Board seat when she could only designate a Residential Board seat. Although Plaintiffs failed to introduce evidence during trial demonstrating that Katherine knowingly tried to evade her contractual restrictions by empowering Robert to act in coordination with her on the Board, the fact remains that Katherine, Robert, and Rita have, at times during this litigation, all been able to retain their Board seats well beyond the expiration of their terms. The integrity and structure of Empire's Board was ultimately compromised.

This Court has discretion under B.C.L. § 619 to order a new election. Given the procedural improprieties that have pervaded the Board election and selection processes for years, it is clear that a new election is required, together with restrictions to remedy the abuses that have permitted Defendants to remain a dominant presence on the Board for many years without the protections mandated by the governing documents.[3]

Accordingly, a new election for each position on Empire's Board must be held within 60 days from this order, with no less than 30 days' notice to the Unit Owners (the "Reset Election"). At the Reset Election, Unit Owners may be elected to the following Board seats, hereby named and assigned initial terms:

1. Residential Seat A shall have a term of three years;
2. Residential Seat B shall have a term of three years;
3. Residential Seat C shall have a term of two years;

[3] Although a four-month statute of limitations typically applies to a challenge of a corporate or condominium election (*Valyrakis v 346 West 48th Street Housing Development Fund Corporation*, 161 AD3d 704 [1st Dept 2018]), Plaintiffs' claim here was that the composition of the Board violated the By-Laws. Plaintiffs' claim is akin to a breach of contract and subject to a six year statute of limitations (*Board of Managers of 120 East 86th Street Condominium v Park Avenue Physicians Realty, LLC et al*, 2018 WL 5636374 at *6 [NY Sup CT, NY County 2018] *aff'd* 2018 WL 3213094 [1st Dept 2018]). Plaintiffs' claim concerning Defendants breaching election By-Laws had not accrued by the commencement of this action. Therefore, Plaintiffs' claim is not time barred, and this Court can rightfully order a new election.

4. Residential Seat D shall have a term of two years;
5. Residential Seat E (designated by the Sponsor) shall have a term of one year;
6. And the Professional Manager Seat should have a term of one year.

Thereafter, successors for each of the Board seats listed above shall be elected to three-year terms. To remedy past abuses, for the six annual elections following the Reset Election, no more than two of Katherine, Robert, and/or Rita (or any of their designees or members of their immediate family) may sit on the six-member Board at any one time.

In all elections, including the Reset Election, Katherine (as Sponsor) may vote only for Residential Seat D and the Professional Manager Seat, in addition to designating Residential Seat E, and may not vote for or designate any other Board Seat.

Separately, Katherine is enjoined from casting votes representing the interest attributable to her unsold Units that are not referenced in the Plan, unless and until the Plan is amended to identify which Units are withheld from sale.

Defendants Breached Their Fiduciary Duties When Hiring CM

To succeed on their breach of fiduciary duty claim, Plaintiffs had to prove that Defendants owed them a fiduciary duty, Defendants failed to satisfy that duty, and Plaintiffs suffered damages as a result (*Burry v Madison Park Owner LLC*, 85 AD3d 699, 699-700 [1st Dept 2011]).

As Board members, Katherine, Robert, and Rita owe fiduciary duties to Empire and its Unit Owners (*Bowery 263 Condominium Inc. v D.N.P. 336 Covenant Avenue LLC*, 169 AD3d 541, 542 [1st Dept 2019]). Katherine, Robert, and Rita breached their fiduciary responsibilities to Empire's Unit Owners by failing to recuse themselves from the selection and repeated renewal of CM as Empire's management company.

Contrary to Defendants' arguments, and consistent with the First Department's decision reinstating Plaintiffs' claims in this case, the Board's decision to repeatedly retain CM is not protected from scrutiny by the business judgment rule. Under the traditional application of the business judgment rule, which is applicable to the boards of directors of cooperative and condominium corporations (*Levandusky v One Fifth Ave.*, 75 NY2d 530, 537 [1990]), a Court's inquiry "is limited to whether the [B]oard acted within the scope of its authority under the [By-Laws] and whether the action was taken in good faith to further a legitimate interest of the condominium (*Perlbinder v Board of Managers of 411 East 53rd Street Condominium*, 65 AD3d 985, 989 [1st Dept 2019]). The business judgment rule does not shield a condominium board's acts of "bad faith and self-dealing" (*Levandusky*, 75NY2d at 537). Nor does the business judgment rule "foreclose inquiry into the disinterested independence of the board chosen to make the corporate decision on its behalf" (*Allannic v Levin*, 57 AD3d 443, 443 [1st Dept 2008] [citing *Auerbach v Bennet*, 47 NY2d 619, 631 [1979]).

Here, at least 50% of the Board was clearly self-interested in the selection of CM as Empire's management company. As fiduciaries, Board members must generally avoid situations "in which a fiduciary's personal interest possibly conflicts with the interest of those owed a fiduciary duty" (*Pokoik v Pokoik*, 115 AD3d 428, 430 [1st Dept 2014]). "Directors are self-interested in a challenged transaction where they will receive a direct financial benefit from the transaction which is different from the benefit to shareholders generally" (*Matter of Converse Tech., Inc.*, 56 AD3d 49, 54 [1st Dept 2008]). The Board's selection (and renewal) of CM clearly was a "self-interested transaction," for Katherine and Robert, and thus they are not entitled to the "business judgment" deference accorded to decisions by independent Board members. Robert is the sole owner of CM, and had full discretion to assign minor maintenance

projects to his other business, Leehi. Katherine, as Robert's spouse, shared an interest in the benefit of CM.

Further, the Court finds that Rita is not a disinterested party. Although Rita testified during trial that she is financially independent from her parents, the record indicates that Rita is often the spokesperson on behalf of her parents to the Board and Unit Owners. Moreover, Rita works in the same office where CM and her parents' other businesses are housed, could not demonstrate a time for the Court where she did not vote in alignment with her parents on Board matters, and was able to run for the Board after receiving ownership of a Unit from Katherine. Moreover, the First Department previously found that the voting members of the Board (which included Katherine, Robert, *and* Rita) were "clearly self-interested" when the Board hired CM (*Tsui,* 135 AD3d at 597-98 [citing *Simpson v Berkley Owner's Corp.*, 213 AD2d 207, 207 [1st Dept 1995]]).

Based on the evidence introduced at trial, the Court finds that Empire's retention of CM was tainted by Defendants' conflicts of interest and was not in the best interests of Empire and its Unit Owners. When examining a Board decision or action, if there is "an inherent conflict of interest, the burden shifts to the interested directors or shareholders to prove good faith and the entire fairness of the" decision (*Alpert v 28 Williams St. Corp.*, 63 NY2d 557, 570 [1984]). Should interested parties attempt to demonstrate elements of fair dealing, like "introducing evidence of efforts taken to simulate arm's length negotiations" they may negate a finding of self-dealing (*id*.). Here, there was no evidence of the Board considering any other potential management companies or undertaking a rigorous and independent process to warrant selecting CM. Rita's testimony that the Board hired CM because Robert was a Unit Owner (which he was not until 2016) was not convincing.

Ultimately, the Court finds that the Board's decisions to hire and retain CM – which included the involvement of self-interested Board members – is not subject to deference under the business judgment rule. In the absence of evidence that CM's hiring was in the best interest of Empire, or that the Board even considered other candidates or subjected CM to competitive vetting, the Court finds that Defendants breached their fiduciary duties to Empire and its Unit Owners.

The question then turns to remedies. Plaintiffs did not submit sufficient evidence to show that Defendants' breach of their fiduciary duties caused monetary harm to Empire or its Unit Owners. While there was some evidence of maintenance problems in the building, leading some Unit Owners to give rent abatements to their tenants (Tr. 149:19 – 151:10 [Heymann]; Tr. 241:19 – 243:9 [Rita]), the evidence that these problems were caused by CM's shortcomings as a management company was sparse.[4]

Much of Plaintiffs' testimony with respect to CM's shortcomings as a management company was anecdotal or based on hearsay and speculation. Unit Owners primarily shared descriptions of building issues relayed to them by tenants. Much of the Plaintiffs' testimony about building issues was generalized, with few examples of CM's alleged mismanagement being tied to specific timeframes. Further, Plaintiffs did not tie CM's alleged negligence to quantifiable, financial harm that Plaintiffs experienced as a result of the Board's hiring of CM.

Similarly, the evidence (mainly, testimony from Plaintiffs themselves) did not establish by a preponderance of admissible evidence that CM's alleged failings precluded Unit Owners

[4] Plaintiffs testified at trial about poor conditions and poor maintenance of the Building, its common areas, and general uncleanliness (*see e.g.*, Tr. 69:14-20 [Abdelnour's testimony about poor maintenance of common areas]; Tr. 104:11-21 [Tsui's testimony about poor maintenance around the Building]; Tr. 148:24 – 149:16 [Heyman's testimony about hot water and vermin issues]).

from obtaining rents at market rates or, if so, offer any credible means for the Court to calculate the monetary amount by which such rates were impacted.

In the absence of financial harm, the Court concludes that the appropriate remedy is to abrogate Empire's management agreement with CM and ensure that the selection of a management company (CM or another company) is undertaken by an independent Board with full disclosure by any self-interested parties. The purpose of a breach of fiduciary duty claim is not merely to "compensate the plaintiff for wrongs committed by the defendant but … to prevent them, by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others, or to which their agency or trust relates") (*Excelsior 57th Corp. v Lerner*, 160 AD2d 407, 409 [1st Dept 1990] [internal quotations and citations omitted]). Accordingly, the Court will require the newly elected Board to hire a new management company for Empire within 90 days of the Reset Election. If CM (or any other company in which a Board member or someone in her or his immediate family has a financial interest) wishes to compete for that position, the Board will appoint a committee of independent directors to make a recommendation to the Board. No Board member (or any member of that Board member's immediate family) who has a financial interest in one or more of the management company candidates shall have any role in or vote upon the selection of the management company.

The Board Failed to Obtain and Distribute Verified Financial Statements to Unit Owners

Article III, Section 9 of the By-Laws requires that the Board annually (or when called for by a vote) provide Unit Owners with "a full and clear statement of the business conditions and affairs of the Condominium, including a balance sheet and profit and loss statement verified by an independent public accountant..."

Robert testified that he and Katherine were responsible for hiring independent public accountants, directing the scope of their work, and providing the information the accountants needed for their reports (NYSCEF Doc. No. 301 ["Robert Chou Transcript Excerpts"] at Tr. 89:22 – 90:8; 91:16-18]). It appears from the record that Katherine and Robert were ill-equipped to handle this task given that Robert did not understand what a verified financial statement was (*id*. at Tr. 91:19-24), and Katherine did not know what a compilation report was or whether the Board was required to provide financial statements to Unit Owners (NYSCEF Doc. No. 300 ["Katherine Chou Transcript Excerpts"]).

The parties' positions as to what "verified by an independent public accountant" requires have been inconsistent and confusing. Defendants argue that the By-Laws do not call for an audit, which they assert is the only category of financial statements recognized by the American Institute of Certified Public Accountants to require account "verification" (NYSCEF Doc. No. 346 ["Defendants' Post-Trial Brief"] at 21). Plaintiffs initially argued (in their summary judgment papers) that the Board was required to provide "audited financial statements" (NYSCEF Doc. No. 214 ["Plaintiffs' Memo of Law in Support of Cross-Motion for Summary Judgment"] at 14). Now, however, in their Post-Trial Brief, Plaintiffs assert that the By-Laws do not require the Board to furnish an audit (NYSCEF Doc. No 347 at 13). During trial, no evidence was proffered by either party to further explain what they think "verified by an independent public accountant" means.

One thing that does seem clear is that Empire's *accountants* do not believe that they "verified" anything. In their statements to Unit Owners, the accountants wrote: "We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services

Committee of the AICPA. **We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management**" (Schreck 2015 Statement at p. 2; Schreck 2016 Statement at p. 2 ["emphasis added"]).

In the absence of guidance from expert witnesses, or any other credible evidence provided by the parties, the Court is not inclined to mandate a specific scope of accounting work. Instead, the Court orders that, within 90 days after the Reset Election, the Board hire independent certified public accountants (which may be the current accountants, if the Board so chooses) to produce annual verified financial statements to Unit Owners, as required by the By-Laws. The Board, in consultation with the chosen accountants and in the exercise of their business judgment, has the authority to determine the scope of work that will constitute the "verification" that is required by the By-Laws.

Plaintiffs are Entitled to Attorneys' Fees Pursuant to B.C.L. § 626(e)

Business Corporation Law § 626(e) provides that successful plaintiffs in a shareholders' derivative action may recoup legal expenses and attorneys' fees from the proceeds of a judgment in favor of the corporation, or in this case, condominium (*Glenn v Hoteltron Systems, Inc.*, 74 NY2d 386, 393 [1989]). Under B.C.L. § 626(e), the Court is authorized to use its discretion and determine whether Plaintiffs' lawsuit conferred "material, lasting benefits" to the condominium and its Unit Owners (*Gusinsky v Bailey*, 66 AD3d 614, 615 [1st Dept 2009]).

The Court finds that Plaintiffs have conferred meaningful benefits to the condominium and its unit owners, particularly with respect to addressing irregularities in Board elections and hiring of the management company. However, all things considered, the Court does not think it would be appropriate to award costs for the entire eight years of prolonged litigation. Instead,

the Court awards Plaintiffs their reasonable attorneys' fees and expenses under B.C.L. § 626(e) for *the trial* of this action, including pre-trial and post-trial briefing.

Conclusion

For all the foregoing reasons, it is hereby:

ORDERED AND ADJUDGED that Katherine (as the Sponsor) is enjoined from casting votes for Board seats representing the interest attributable to her unsold Units that are not referenced in the Plan, unless and until the Plan is amended to identify which Units are withheld from sale; it is further

ORDERED AND ADJUDGED that a Reset Election for each position on Empire's Board must be held within 60 days from this order, with no less than 30 days' notice to the Unit Owners. At the Reset Election, Unit Owners may be elected to the following Board seats, hereby named and assigned initial terms:

1. Residential Seat A shall have a term of three years;
2. Residential Seat B shall have a term of three years;
3. Residential Seat C shall have a term of two years;
4. Residential Seat D shall have a term of two years;
5. Residential Seat E (designated by the Sponsor) shall have a term of one year;
6. And the Professional Manager Seat should have a term of one year; and
7. In subsequent elections, successors for each of the Board seats listed above shall be elected to three-year terms; it is further

ORDERED AND ADJUDGED that for the six annual elections following the Reset Election, no more than two of Katherine, Robert, and/or Rita (or any designees or members of their immediate family) may sit on the six-member Board at any one time; it is further.

ORDERED AND ADJUDGED that in all elections, including the Reset Election, Katherine (as Sponsor) may vote only for Residential Seat D and the Professional Manager Seat, in addition to designating Residential Seat E, and may not vote for or designate any other Board seats; it is further

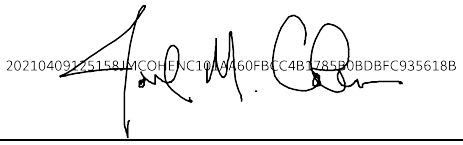
ORDERED AND ADJUDGED that the current contract between Empire and Chou Management is abrogated, effective upon the newly constituted Board's selection of a management company, which shall be done within 90 days after the Reset Election. If Chou Management (or any other company in which a Board member or someone in her or his immediate family has a financial interest) wishes to compete for that position, the Board will appoint a committee of independent directors to make a recommendation to the Board. No Board member (or any member of that board member's immediate family) who has a financial interest in one or more of the management company candidates shall have any role in or vote upon the selection of the management company; it is further

ORDERED AND ADJUDGED that within 90 days after the Reset Election, the Board will hire independent certified public accountants to produce annual verified financial statements to be distributed to Unit Owners prior to each Annual Unit Owners Meeting. The Board, in consultation with the chosen accountants and in the exercise of their business judgment, has the authority to determine the scope of work that will constitute the "verification" that is required by the By-Laws; and it is further

ORDERED AND ADJUDGED that Plaintiffs are awarded attorney's fees pursuant to B.C.L. § 626(e) for the trial of this matter, including pre-trial and post-trial briefing, and Plaintiffs are directed to submit to the Court a bill of costs, with notice to Defendants, within thirty days of this order.

This constitutes the decision and order of the Court.

ENTERED:



DATE: 4/9/2021 **JOEL M. COHEN, JSC**

Check One: [x] **Case Disposed** [ ] **Non-Final Disposition**

Check if Appropriate: [ ] **Other (Specify _____)**