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Expert Analysis

Recent Decision Limits Liability Of Condo Sponsor's Principal

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On May 24, 2017, a New York appeals court dismissed construction defect claims against a condominium sponsor's managing members and principals. The plaintiff Board of Managers sought to hold these individual defendants personally liable for the corporate sponsor's breach of contract. But in *Board of Managers of 125 North 10th Condominium v. 125North10*, 150 A.D.3d 1065 (2d Dept. 2017), the court extended to a sponsor's principals and members the rule which precludes claims against sponsors based on their alleged violations of the offering plan, merely by reason of those individuals' certification of the offering plan in accordance with the requirements of the Martin Act.

That rule, reiterated in 2009 by the Court of Appeals in *Kerusa Co. v. W10Z/515 Real Estate Ltd. Partnership*, 12 N.Y.3d 236, 244 (2009), states that "'[t]he Attorney General bears sole responsibility for implementing and enforcing the Martin Act' [citation omitted]; there is no private right of action under the statute." The court went on to hold that "a purchaser of a condominium apartment may not bring a claim for common-law fraud against the building's sponsor when the fraud is predicated solely on alleged material omissions from the offering plan amendments mandated by the Martin Act." Id. at 239

> Citing Limited Liability Company Law §609(a), the court in 'Board of Managers of 125 North 10th Condominium' expressly left open the possibility of potential liability of sponsor's principals and members pursuant to veil-piercing or alter-ego theories.

The Court of Appeals concluded that the plaintiff had no common-law claim for fraud, as distinct from a claim under the Martin Act which only the Attorney General may bring, because plaintiff's pleading failed to allege active concealment unrelated to alleged omissions from Martin Act disclosures. Id. at 245-46.

The Appellate Division, Second Department, in 2011 distinguished *Kerusa* holding that such common-law causes of action are not preempted by the Martin Act. *Caboara v. Babylon Cove Development*, 82 A.D.3d 1141, 1142-43 (2d Dept. 2011). Later that same year, the Court of Appeals concurred with that analysis in *Assured Guar. (UK) v. J.P. Morgan Inv. Management*, 18 N.Y.3d 341, 352-53 (2011), holding:

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> [A] private litigant may not pursue a common-law cause of action where the claim is predicated solely on a violation of the Martin Act or its implementing regulations and would not exist but for the statute. But, an injured investor may bring a common-law claim (for fraud or otherwise) that is not entirely dependent on the Martin Act for its viability. Mere overlap between the common law and the Martin Act is not enough to extinguish common-law remedies.

In so holding, the Court of Appeals in *Assured Guar.* endorsed the holding in *Board of Mgrs. of Marke Gardens Condominium v. 240/242 Franklin Ave.*, 71 A.D.3d 935, 936 (2d Dept. 2010), which sustained common-law and statutory fraud claims against a sponsor's principal. *Assured Guar.*, 18 N.Y.3d at 352, n.2; see also *Board of Mgrs. of Marke Gardens Condominium v. 240/242 Franklin Ave.*, 20 Misc.3d 1138(A) (Sup. Ct. Kings Co. 2008).

Similarly, in *Meadowbrook Farms Homeowners Ass'n v. JZG Resources*, 105 A.D.3d 820, 821 (2d Dept. 2013), the court held:

> Since the plaintiff's common-law causes of action to recover damages for breach of contract and derivative declaratory judgment causes of action are not 'predicated solely on a violation of the Martin Act or its implementing regulations,' they are not preempted by the Martin Act [citations omitted].").

Thus, the Appellate Division, Second Department's holding in *Board of Managers of 125 North 10th Condominium* merely extended to a sponsor's principals and members the existing rule barring private Martin Act claims against a sponsor.

Moreover, citing Limited Liability Company Law §609(a), the court in *Board of Managers of 125 North 10th Condominium* expressly left open the possibility of potential liability of sponsor's principals and members pursuant to veil-piercing or alter-ego theories.

The court in *Board of Managers of 125 North 10th Condominium* also did not overrule its previous holding in *Board of Managers of Beacon Tower Condominium v. 85 Adams Street*, 136 A.D.3d 680 (2d Dept. 2016), which not only preserved such veil-piercing claims, but held further that, by their execution of the certification page of the offering plan, the sponsor's principals and members had signified that they directly participated in the transactions at issue by virtue of their control of the sponsor. In *Board of Managers of Beacon Tower Condominium*, the court held that such allegations are sufficient to support the claim that the sponsor's principals and members participated in the commission of a tort as alleged, and that they are, therefore, not insulated from liability by Limited Liability Company Law §609(a).

In sum, a sponsor's principals and members may still be held liable for construction defect claims, provided the plaintiff has sufficiently alleged causes of action that are not "predicated solely on a violation of the Martin Act or its implementing regulations," or "based solely on alleged violations of the offering plan, merely by their certification of that offering plan in their representative capacities on behalf of the sponsor."

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