Individual Liability of Board Members After *Fletcher v. The Dakota*

By Vincent Di Lorenzo

Introduction

In *Fletcher v. The Dakota, Inc.* the First Department reconsidered when board members of cooperative corporations will be individually liable for the discriminatory actions of the board.[1] Prior to *Fletcher* board members had relied on the court's decision in *Pelton v. 77 Park Avenue Condominium*.[2] It stated:

> In bringing an action against the individual members of a cooperative or condominium board based on allegations of discrimination or similar wrongdoing, plaintiffs were required to plead with specificity independent tortious acts by each individual defendant in order to overcome the public policy that supports the business judgment rule.....[3]

In *Pelton* the court refused to impose individual liability on board members because neither the complaint nor plaintiffs' submissions "assert a specific claim against any of the individual defendants other than as a member of the 77 Park board."[4] Specifically, plaintiffs failed to show that any board member engaged in "individual wrongdoing…separate and apart from the actions taken by the board members collectively on behalf of the condominium."[5]

Six years later, in the *Fletcher* decision, the First Department concluded that in the *Pelton* decision it had misinterpreted the governing case law.[6] It rejected the independent tortious act requirement and ruled that "although participation in a breach of contract will typically not give rise to individual director liability, the *participation* of an individual director in a corporation's tort is sufficient to give rise to individual liability."[7] Is the *Fletcher* court's interpretation and application of the case law correct? If so, what precise involvement triggers individual liability for board members?

Fletcher's Reading of Prior Case Law—Breach of Contract Actions

The *Pelton* decision's recognition of an independent tortious act requirement was based on the Court of Appeals' decision in *Murtha v. Yonkers Child Care Assn.*[8] *Murtha* involved a claim of breach of a contract of employment by Yonkers Child Care Association. The court addressed the liability of individual defendants in tort for inducing a breach of contract. It concluded that a director or officer of a corporation is not personally liable to one who has contracted with the corporation on the theory of inducing a breach of contract merely because, while acting for the corporation, the director or officer made decisions and took steps that resulted in the corporation's contractual promise being broken.[9] Rather, the officer or director is immune from liability "if it appears that he is acting in good faith as an officer [or director]…[and did not commit] independent torts or predatory acts directed at another."[10]

Although the *Murtha* decision was indeed a decision regarding individual director liability for inducing a breach of contract, the decision did not explain why actions alleging breach of contract, and seeking to impose individual liability on directors, should be treated differently than actions alleging other wrongdoing—e.g. other tortious conduct, or discriminatory conduct. However, the *Murtha* decision cited lower court decisions that did explain why the courts imposed an independent tortious act requirement for personal liability on the part of board members for inducing a breach of the corporation's contract.[11] The First Department explained in *Brookside Mills, Inc. v. Raybrook Textile Corporation*,[12] a decision cited by the Court in *Murtha*, that:

> To hold otherwise would be dangerous doctrine, and would subject corporate officers and directors continually to liability on corporate contracts and go far toward undermining the limitation of liability which is one of the principal objects of corporations.[13]

The court further explained that the actions of the two directors in question were taken on the corporation's behalf in the exercise of business judgment, and if their actions resulted in a breach of the corporation's obligations under the contract in question, it was the corporation alone that was liable.[14] Similarly, in *Buckley v. 112 Central Park South Inc.*,[15] also cited by the *Murtha* decision, the First Department explained that to be immune from individual liability the corporate officers or directors must have been acting in good faith,[16] i.e., in the interest of the corporation. The *Buckley* decision further explained that:

> Running through many opinions upon the subject, there is the thread of thought that an officer of a corporation may have the right and perhaps the duty of inducing the corporation to breach a contract of the corporation with a third party if it appears to him to be for the best interests of the corporation to do so.… This, of course, is but one facet of the freedom of action rule upon which the immunity is based.[17]

Thus, the case law addressing individual director liability for inducing a breach of contract by the

corporation contains two reasons to reject a mere participation standard as the threshold for liability: (a) fear of excessive exposure of board members to litigation, and (b) a recognition that what is wrongful conduct on the part of the corporation, acting through its officers and directors, is not necessarily wrongful conduct on the part of the individual director or officer.

Fletcher's Application of Case Law Involving Tortious Conduct

The *Fletcher* court's refusal to apply the independent tortious act requirement to allegations of discriminatory conduct by board members is also a correct reading of the existing case law. However, the New York Court of Appeals and the Second Circuit have not addressed the exact question at hand. The *Fletcher* court, first, correctly noted that decision-making tainted by discriminatory considerations is not protected by the business judgment rule.[18] The court, second, highlighted that the Court of Appeals has instructed, generally, that the New York City Human Rights Law must be construed "broadly in favor of discrimination plaintiffs, to the extent that such a construction is reasonably possible."[19]

In *Fletcher* the court then ruled that: "the *participation* of an individual director in a corporation's tort is sufficient to give rise to individual liability."[20] The court cited prior case law supporting the position that a corporate director is not liable in tort only when the director commits a tort independent of the tort committed by the corporation. Rather, personal liability may be imposed for an action taken regardless of whether the officer or director acted on behalf of the corporation in the course of official duties.[21] However, the *Fletcher* court's stated threshold for individual liability raises a great deal of uncertainty, because that decision does not clearly indicate how or when a director can avoid liability. It is not clear if "participation" involves merely casting a vote consistent with the decision of a majority of the board, regardless of whether the vote of the particular director was tainted, i.e. could independently be deemed a violation of the civil rights laws.

The case law involving tortious conduct generally on the part of a corporate board states that a director may be held individually liable if the director either participated in the tort or else directed, controlled, approved or ratified the decision that led to the plaintiff's injury.[22] However, the decisions applying this standard have involved proof of some connection to the misconduct in question. Thus, "participation" has been found to exist when the officer or director *directly* committed the tort even though he was acting in his capacity as officer or director of the corporation.[23] No personal liability attaches if an officer or director took no part in the tort committed by the corporation.[24]

A scenario where the Court of Appeals has directly addressed the personal liability of a corporate officer or director for tortious conduct has involved a specific tort, an action for fraud against a corporation and its officers. The Court of Appeals discussed the threshold for individual liability. It noted:

> Joseph Russo's individual liability is another matter. As a general proposition, corporate officers and directors are not liable for fraud unless they personally participate in the misrepresentation or have actual knowledge of it… Mere negligent failure to acquire knowledge of the falsehood is insufficient.[25]

The tort of fraud requires, *inter alia*, an untrue representation of a material fact, known to be untrue or with reckless indifference to truth or falsity, as well as intention to deceive.[26] Thus the Court of Appeals has ruled that the "participation" in a corporate fraud by a corporate officer or director, which can lead to personal liability, requires some direct involvement in the actual wrongdoing.

In summary, the corporate case law that has addressed the individual liability of board members, apart from cases alleging discriminatory conduct, has involved allegations of corporate wrongdoing in the form of inducing breach of contract, commission of a tort generally, and commission of the tort of fraud. In all of these cases, to hold a director or officer individually liable some individual wrongdoing on the part of the director or officer appears to be required.

As discussed above, the action taken by a board member, in his or her capacity as a board member, that might be deemed to be inducing a breach of contract is not necessarily wrongful conduct, since the best interest of the corporation may be served by inducing a breach of contract and the board member must always act in the interest of the corporation. In other words the individual board member's action, distinct from the corporation's action, is not improper. As a result the courts imposed an independent tortious act requirement. Similarly, the case law imposing individual liability on a board member for torts generally has in fact involved some individual involvement in the wrongdoing by the director. Where the tort is the negligent conduct itself, the courts have held a director individually liable when the director was himself guilty of the negligent conduct, or controlled or ratified the negligent conduct of others. Where the tort is fraud, the courts have made it clear that an individual director's conduct becomes actionable when there is also evidence of personal participation in the fraud, or at least actual knowledge of the falsity of a representation made by the board and intention to deceive.

Many cases of discriminatory conduct are arguably similar. The misconduct by the board is not necessarily misconduct by each director. The denial of an application to purchase, for example, is not a wrongful act unless the denial was due to discriminatory reason(s). A member of the board that voted to deny an application to purchase is not engaged in wrongful

conduct unless that particular individual's vote was motivated by discriminatory reason(s).

Case Law Involving Discriminatory Conduct

In the *Fletcher* decision itself the cause of action against an individual director, Barnes, for retaliation against Fletcher for opposing alleged discriminatory conduct by the board while he was president of the board, was dismissed based on a lack of factual allegation that Barnes was aware of Fletcher's protected activity (opposition to alleged discriminatory conduct).[27] However, the action was dismissed without prejudice because discovery may reveal that Barnes was indeed aware of Fletcher's protected activity.[28] Thus, the court's opinion suggests that as long as Barnes was aware of the protected activity and "participated" in the *board's* vote to deny Fletcher the right to purchase an apartment adjacent to his own, Barnes could be individually liable. In other words, if Barnes voted to deny Fletcher's application but did *not* do so for reasons prohibited by the civil rights laws, it is not clear if the court's view of the required threshold of "participation" would allow Barnes to avoid liability.

There is some additional case law in the federal district courts supporting this low threshold for individual director liability. In *Sallee v. Tropic Seas, Inc.* the court considered whether the action against two individual directors should be dismissed.[29] In that case the court certainly did not apply an independent tortious act requirement. Indeed, it did not even require that the individual directors *actively* participated in the discriminatory conduct.[30] Rather, the court reasoned that:

> Because the duty to comply with the Fair Housing Act is nondelegable, a corporation's officers and directors may be held individually liable for their failure to ensure the corporation's compliance… This is so even where the individual director or officer did not actively participate in the alleged discrimination and did not subjectively intend to discriminate against the complainant.[31]

In the *Tropic Seas* case the plaintiffs alleged a violation of the Fair Housing Act Amendments of 1988 which prohibits discrimination based on "familial status."[32] Plaintiffs held a proprietary leasehold interest in a Wakiki cooperative apartment complex. The state circuit court had found that the corporation, Tropic Seas Inc., had violated the statute, and HUD had issued a Determination of Reasonable Cause and Charge of Discrimination against Tropic Seas and members of the board of directors. However, the alleged discriminatory actions were all, seemingly, actions of the board in enforcing an occupancy policy of limiting occupancy to two persons.[33] When denying the motion for summary judgment by two individual directors the court noted that:

> The acts and omissions alleged by the Sallees [plaintiffs] give rise to at least a genuine issue of material fact as to whether Tropic Seas engaged in discriminatory conduct *during the tenures of Worth and Mello*[34] on the board of directors. Summary judgment in favor of Worth and Mello is thus not appropriate. Thus, the formal action(s) *of the board* during the tenure of the individual directors was enough to potentially hold the directors individually liable.[35]

Arguably, however, *Tropic Seas* is a distinct case. The decision to enforce the occupancy policy itself had the effect of improperly denying access to the plaintiffs based on "familial status" because the couple in question had a child. Any board member voting in favor of enforcing the occupancy restriction would be participating in the civil rights violation. However, what level of participation would be required if the decision itself (e.g. to deny an application to purchase) is not necessarily improper, but only becomes improper based on a prohibited basis (reason) for the decision?

The case law involving housing discrimination does not delineate the degree of culpability or involvement of an individual board member in group decisions such as a board decision to deny an application to purchase in such a scenario. The only case law in the cooperative or condominium setting in which board members were *not* liable for alleged discriminatory actions involved a situation in which the individual board members did not participate in the decision at all.[36] Moreover, in the lower federal courts in New York the cases in which a director *was* found to be individually liable involved a situation in which the individual board member, distinct from the board, directly and willfully violated the Civil Rights laws.[37]

Should the Courts Impose a Higher or Lower Threshold?

In the context of individual liability of board members of cooperative corporations or condominium associations, the differing viewpoints found in the recent *Fletcher* decision and the older *Pelton* decision are a difference in viewpoint as to which public policy deserves primacy. The *Fletcher* decision emphasizes the policy that the NYC Civil Rights Law, and no doubt the state or federal civil rights laws, should be construed broadly in favor of discrimination plaintiffs.[38] This is arguably to discourage discriminatory conduct. The *Pelton* decision recognizes that aim. However, it emphasizes the adverse impact of a low threshold for individual liability for board members who volunteer to serve the interests of all unit owners. The court noted that board policies and decisions are controlled by the board collectively and not by any individual member.[39] Yet,

> the Supreme Court's decision, if permitted to

> stand, would, without any evidence of individual wrongdoing, subject these defendants to expensive, intrusive and time-consuming litigation…hardly a fitting reward for those "fellow tenants who volunteer their time, without compensation" as members of a governing body that takes on the burden of managing the property for the benefit of the other owners (see Levandusky, 75 N.Y. 2d at 536-537)… the threat of baseless litigation, with its attendant serious financial and personal burdens, would pose a formidable obstacle to those willing to volunteer their talent, experience and knowledge for the common good of their homeowner communities by serving on such a board.[40]

The risk becomes a serious risk in light of the existing threshold utilized for plaintiffs to establish a prima facie case. Namely,

> Plaintiffs may establish a prima facie case of housing discrimination by showing (1) that they are members of a protected class; (2) that they sought and were qualified to rent or purchase the housing; (3) that they were rejected; and (4) that the housing opportunity remained available to other renters or purchasers.[41]

Thus, under the standard announced in *Fletcher* it is possible that any director that voted with the majority of the board in a decision involving a protected class or activity could be named as a defendant in a lawsuit seeking to hold that director personally liable, even if no evidence is presented that the director in question engaged in any discriminatory conduct, e.g., even if the director had a valid reason to deny consent to a purchase or lease. Such a lawsuit would not be dismissed. Rather, the burden shifts and the individual director now must come forward with evidence that his actions were not motivated by considerations of race, for example.[42] Moreover, in attempting to satisfy that burden of proof the courts will carefully scrutinize reasons that are not objective in nature and view subjective explanations with "considerable skepticism."[43]

Such a scenario would raise the risk of continually subjecting corporate officers and directors to personal liability, a risk the courts sought to avoid by imposing the independent tortious act requirement in cases alleging breach of contract. This was the same risk that had originally persuaded the court in *Pelton* to impose the same requirement for individual liability in cases alleging discriminatory conduct, especially since board members are volunteers taking on the burden of managing the cooperative or condominium. It would be up to the Court of Appeals to decide if this public policy should be paramount and, if so, to recognize an individual "tortious" act requirement when the alleged wrongdoing is a violation of the civil rights laws.

Even if the Court of Appeals chooses not to extend the independent tortious act requirement to civil rights violations, it must clarify what threshold the *Fletcher* court intended to impose for individual liability on the part of board members for alleged discriminatory conduct by the board as a whole. A clarification might be to clearly embrace the commission of tort standard followed in the New York case law. Namely, a director would be individually liable only if he or she personally participated in the discriminatory conduct (i.e., not merely the decision but also the unlawful motivation for the decision) or ratified it.

It is interesting that the case law involving alleged employment discrimination and individual liability of corporate officers or supervisory personnel has also focused on the degree of individual involvement in the wrongful decision. The courts have repeatedly ruled that for an individual to be liable in damages for discriminatory conduct under the New York State or New York City Human Rights Laws the individual must have "actively participated in the discrimination."[44] For liability under §§ 1981 and 1983 plaintiff must show some "personal involvement" by the individual defendant in alleged constitutional deprivations.[45] Such case law suggests that a lower threshold for "participation," seemingly embraced by the *Fletcher* decision, is not the wisest standard to impose.

Endnotes

1. 948 N.Y.S.2d 263 (1st Dep't 2012).
2. 38 A.D.3d 1, 825 N.Y.S.2d 28 (1st Dep't 2006).
3. *Id.* at 9-10, 825 N.Y.S.2d at 34.
4. *Id.* at 10, 825 N.Y.S.2d at 34.
5. *Id.* at 10, 825 N.Y.S.2d at 35.
6. *See Fletcher*, 948 N.Y.S.2d at 268.
7. *Id.* at 266 (emphasis added).
8. 45 N.Y.2d 913 (1978). The court also cited the First Department's earlier decision in *Konrad v. 136 E. 64th Corp.*, 246 A.D.2d 324 (1st Dep't 1998). That decision involved an allegation of breach of fiduciary duty, not breach of contract.
9. *See Murtha*, 45 N.Y.2d at 914-915.
10. *Id.* at 915 (quoting from the Appellate Division's decision in Buckley v. 112 Cent. Park South, 285 A.D. 331 (1st Dep't 1954)).
11. *See id.* at 915.
12. 276 A.D. 357, 94 N.Y.S.2d 509 (1st Dep't 1950).
13. *Id.* at 367, 94 N.Y.S.2d at 519.
14. *Id.* at 368, 94 N.Y.S.2d at 519.
15. 285 A.D. 331, 136 N.Y.S.2d 233 (1st Dep't 1954).
16. *Id.* at 334, 136 N.Y.S.2d at 236.
17. *Id.* at 335-336, 136 N.Y.S.2d at 237 (citations omitted).
18. *See Fletcher*, 948 N.Y.S.2d at 268 (explaining the applicability of the rule in *Pelton*).
19. *Id.* at 268-9, quoting Albunio v. City of New York, 16 N.Y.3d 472, 477-8 (2011). The *Albunio* decision broadly construed the word "opposed" to any practice forbidden by the New York City Human Rights law in the context of a claim of retaliation for opposition to discriminatory conduct.
20. *Id.* at 266 (emphasis added).
21. *See* American Express Travel Related Servs. Co. v. North Atlantic Resources, 261 A.D.2d 310, 311, 691 N.Y.S.2d 403, 403 (1st Dep't 1999).

22. *Fletcher,* 948 N.Y.S.2d at 268 (citing Fletcher, Cyc. of Law of Corporations); *see generally* Martin Petun, *The Curious Case of Directors' and Officers' Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law*, 59 Amer. U. L. Rev. 1661, 1668 (2010).

23. *See e.g., Peguero,* 58 A.D.3d 556 (Jeffrey Farkas, president of the corporation, cannot have the complaint dismissed against him merely because his actions were taken in his capacity as an officer of the corporation. However, the "commission of tort" doctrine permits personal liability to be imposed for misfeasance or malfeasance, i.e., an affirmative tortious act; personal liability cannot be imposed on a corporate officer for nonfeasance, i.e., a failure to act); Savanah T & T Co., Inc. v. Force One Express Inc., 58 A.D.3d 409, 872 N.Y.S.2d 83 (1st Dep't 2009) (defendant Phil Notaro, the corporate defendant's principal, was held personally liable for misappropriation where he withheld plaintiff's goods from them and coerced Edwin Baldin, the plaintiff's principal, into signing a purported lien agreement); Rajeev Sindhwani, M.D., PLLC v. Coe Business Service Inc., 52 A.D.3d 674, 861 N.Y.S.2d 705 (2d Dep't 2008) (the evidence adduced at trial established that Coe was responsible for the determination to withhold the subject records from the plaintiff. Accordingly, the jury rationally determined she personally was liable for conversion).

24. The participation theory of tort liability provides that an officer or director who takes part in the commission of a tort by the corporation is personally liable therefor. However, "an officer [or director] of a corporation who takes no part in the commission of a tort committed by the corporation is not personally liable to third persons for such a tort, nor for the acts of other agents, officers or employees of the corporation in committing it, unless he specifically directed the particular act to be done or participated, or cooperated therein," Mill Run Associates v. Locke Property Co., Inc., 282 F. Supp.2d 278 (E.D. Pa. 2003) (discussing the general, if not universal, rule and citing Fletcher, Cycl. of the Law of Private Corporations); *see also* Clark v. Pine Hill Homes, Inc. 112 A.D.2d 755, 492 N.Y.S.2d 253 (4th Dep't 1985) (a corporate officer is not liable for the negligence of the corporation merely because of his official relationship to it. It must be shown that the officer was a participant in the wrongful conduct); Wesolek v. Jumping Cow Enterprises, Inc., 51 A.D.3d 1376, 1378-9, 857 N.Y.S.2d 859 (4th Dep't 2008) (dismissing action against corporate director).

25. Marine Midland Bank v. John E. Russo Produce Co., Inc., 50 N.Y.2d 31, 44, 427 N.Y.S.2d 961, 968 (1980) (citations omitted); *see also* Ecuador Importadora-Exportadora CIA, LTDA v. ITF (Overseas) Corporation, 94 A.D.2d 113, 117-118, 463 N.Y.S.2d 208 (1st Dep't 1983) (since director Cordero was under the impression Intrafina had more than enough cash to meet its obligations he could not be held personally liable. Even if Cordero could be considered culpable of nonfeasance in this regard to his corporate duties, his liability does not extend to a third party).

26. *E.g.,* Channel Master Corp. v. Aluminum Ltd. Sales, Inc., 4 N.Y.2d 403, 151 N.E.2d 833, 176 N.Y.S.2d 259 (1958).

27. *Fletcher,* 948 N.Y.S.2d at 270.

28. *Id.* at 273.

29. 887 F. Supp. 1347, 1366 (D. Haw. 1995).

30. *Id.* at 1347, 1365.

31. *Id.* at 1365.

32. *Id.* at 1353.

33. *Id.* at 1352.

34. *Tropic Seas,* 887 F. Supp.at 1365 (emphasis added).

35. *Id.* at 1365 (emphasis added).

36. *See* Sayeh v. 66 Madison Avenue Apt. Corp., 73 A.D.3d 459, 460, 901 N.Y.S.2d 26, 28 (1st Dep't 2010).

37. *See* discussion of jury's findings in Biondi v. Beekman Hill House Apartment Corporation, 94 N.Y.2d. 659, 664, 709 N.Y.S.2d 861, 863 (2000) (the jury in the federal action found Biondi willfully violated the Broomes' and Demou's civil rights and imposed personal liability on him); s*ee also* Broome v. Biondi, 17 F.Supp. 2d 211, 229 n. 4 (S.D.N.Y. 1997) (the jury found Beckman Hill House Apartment Corporation liable, the members of the board of directors liable in their official capacity, and Nicholas Biondi liable in his personal capacity).

38. *Flecther,* 948 N.Y.S. at 268-9.

39. *Pelton,* 38 A.D.3d at 10-11, 825 N.Y.S.2d at 35.

40. *Id.*

41. Mitchell v. Shane, 350 F.3d 39, 47 (2d Cir. 2003); *see also* Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1038 (2d Cir. 1979); Broome, 17 F. Supp. 2d 211, 216.

42. *See Robinson,* 610 F.2d at 1039.

43. *Id.* at 1040.

44. *E.g.,* Hirsch v. Columbia Univ., 293 F. Supp. 2d 372, 378 (S.D.N.Y. 2003) and cases cited therein; Westbrook v. City University of New York, 591 F. Supp. 2d 207, 224 (E.D.N.Y. 2008).

45. *E.g., Westbrook,* 591 F. Supp.2d 207, and cases cited therein.

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