



MEMORANDUM

TO: REF Attorneys, Law Students, Paralegals

DATE: 10/6/87

FROM: Mary Sabatini DiStephan *MSD*

RE: Holder of Unsold Shares

Attached is a copy of an explanation of who is a holder of unsold shares which the Court has asked us to supply in a case at which Gerry Hurwitz was present. I thought you might like a copy for your files.

MSD:kd

Attachment

DEFINITION OF HOLDER OF UNSOLD SHARES

"Unsold shares are any shares not subscribed to and fully paid for prior to closing. At or prior to closing, unsold shares must be acquired by the sponsor or financially responsible individuals produced by the sponsor. A holder of unsold shares is the sponsor or any individual designated to hold unsold shares by the sponsor. Such shares shall cease to be unsold shares when purchased by a purchaser for occupancy." (13 NYCRR Section 18.3(w)(1)) (emphasis added).

The key word in this definition is "designated". When a sponsor holds on to unsold shares after the closing he may, thereafter, transfer those shares to others, not necessarily to "holders of unsold shares". If he designates the grantee of these shares as a "holder of unsold shares" then that individual or entity* becomes a holder of unsold shares. This "designation" is usually evidenced by an amendment to the plan required by 13 NYCRR Section 18.3(w)(ii) disclosing his or its identity, business address, background and experience, prior convictions, injunctions, and judgments against it, prior real estate securities offerings within the past five years and its relationship to the sponsor, the selling agent, managing agent or provider of services to the coop. Additionally such a holder of unsold shares must comply with the escrow and trust fund provisions of General Business Law (GBL) Sections 352-h and 352-e(2-b) and must register as a broker-dealer pursuant to GBL Section 359-e unless already registered and must also supply to the Department of Law a signed registrant information form ("RI-1") concerning prior convictions, judgments, administrative actions, bankruptcy, employment and business affiliations and an affidavit of prior public offerings of cooperative interests in realty with addresses and dates of first closings (13 NYCRR Section 18.3(w)(9), (10)). Such a holder of unsold shares has the obligation to amend the plan to provide current and accurate information about the offering and must provide prospective purchasers with a copy of the offering plan and all filed amendments (13 NYCRR Section 18.3(w)(11)). Holders of unsold shares must also abide by more stringent rules for cancelling their proprietary leases (13 NYCRR 18.3(w)(12)).

* The Tax Reform Act of 1986 changed the definition of tenant stockholder from "individual" to "person" and therefore, for tax years beginning after 1986, corporations, trusts, estates, partnerships, or other entities may qualify as tenant stockholders of cooperative housing corporations if they satisfy the requirements heretofore applicable to individual tenant stockholders.

These obligations are normally associated with possible benefits for this special category of purchaser. The sponsor may provide in the plan and in the corporate documents and proprietary lease that these holders of unsold shares so designated as such by him do not need the consent of the board or managing agent to use, lease, sublet, sell, pledge or transfer unsold shares and/or do not have to pay transfer fees (flip taxes), that they may use the apartments as models or selling offices and may make alterations to the units without the consent of the apartment corporation (13 NYCRR 18.3(w)(8)). Normally, bearing the burdens associated with being a holder of unsold shares is the quid pro quo for the benefits obtained from such status. Essentially a holder of unsold shares stands in the shoes of a principal of the sponsor.

It is not, however, up to the purchaser to say if he or it is a "holder of unsold shares". Rather it is the sponsor who must designate such a holder since the sponsor must represent in the plan that he will designate only individuals (or, now, entities) who are financially responsible (13 NYCRR Section 18.3(w)(5)). The sponsor needs to choose these individuals (or entities) wisely since the sponsor must guarantee payment of all maintenance charges and assessments due from a holder of unsold shares (13 NYCRR Section 18.3(w)(3)). If the holder doesn't pay, the sponsor must. It is clear, then, that all unsold shares held by sponsor and later sold by him do not necessarily result in the grantee become a "holder of unsold shares" entitled to whatever benefits are associated with such status. This is true notwithstanding the fact that the grantee buys for investment and does not take occupancy. In fact, the regulations make provision for just such purchasers who are not designated by the sponsor as holders of unsold shares but who buy for investment or buy a unit occupied by a non-purchasing tenant (13 NYCRR Section 18.3(x) if 3 or more apartments are purchased, 13 NYCRR Section 18.3(n) regardless of the number of units if occupied by a non-purchasing tenant).

The sentence in the regulation which states that "[s]uch shares cease to be unsold shares when purchased by a purchaser for occupancy" (13 NYCRR Section 18.3(w)(1)) does not imply that all sponsor's shares that are sold for investment automatically become units held by holders of unsold shares. The sentence does not present an all-inclusive limitation. Although no purchasers for occupancy are "holders of unsold shares", neither are all purchasers for investment "holders of unsold shares". The sentence is meant to imply that when a holder of unsold shares or a member of his immediate family takes occupancy of a unit associated with shares for which he is a designated holder, such status as an unsold shareholder is lost (together with all the benefits and burdens associated with such status). This sentence in the regulation was meant to stop the sponsor from designating a never-ending line of holders who take occupancy but who would be able to avoid consent requirements by the apartment corporation which will eventually be controlled by non-sponsor affiliated tenant shareholders.

It would be possible to have later purchasers from holders of unsold shares deemed to be holders of unsold shares but only if the sponsor so designated the new purchasers as such even though the sponsor did not directly sell to the new purchaser.

It would appear in the case at bar that the purchaser would have to produce some evidence of the sponsor's designation of him as a holder of unsold shares as well as compliance with the obligations of such a holder in order to avail himself of the privileges associated with such status. Such obligation would include his updating of the offering plan and providing the offering plan and all amendments thereto to his purchaser before accepting a contract.

I hope this expanded definition of what is a holder of unsold shares is helpful to the Court in making its determination.

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