

STATE OF NEW YORK
SUPREME COURT COUNTY OF MADISON

JAMES C. SANFORD, et al.,

Plaintiffs

vs.

COLGATE UNIVERSITY,

Defendant.

DECISION and JUDGMENT
Index No. 05-1738

APPEARANCES OF COUNSEL

Smith, Sovik, Kendrick & Sugnet, P.C. (Kevin E. Hulslander, Esq., of counsel) for the plaintiffs;

Bond, Schoeneck & King, PLLC (Edward R. Conan, Esq., of counsel) for the defendant.

OPINION OF THE COURT

Dennis K. McDermott, J.

This is a members' derivative action brought pursuant to section 623 of the Not-for-Profit Corporation Law. Plaintiffs claim to represent at least five percent of the members of Beta Theta Pi Corporation ("BTP Corporation"), a New York not-for-profit corporation which formerly owned the Beta Theta Pi fraternity house at Colgate University in Hamilton, New York. Its members are alumni of Colgate and former members of the Colgate chapter of that fraternity. It is the May, 2005 sale of that property by BTP Corporation to Colgate which the plaintiffs now seek to rescind.

In 2003, Colgate's Board of Trustees unanimously adopted its "new residential education

plan”, under which Colgate would require substantially all of its undergraduate students to reside in university-owned housing effective July 1, 2005. A number of national fraternities and sororities have chapters at Colgate, and many of them occupied fraternity or sorority houses owned by affiliated alumni corporations. Among them was the local chapter of Beta Theta Pi (“BTP”). As part of its plan, Colgate announced that it would continue to recognize the various Greek-letter organizations provided that those which owned fraternity or sorority houses transferred ownership of those houses to the university by November 30, 2004. Colgate would negotiate transfer prices with the respective alumni corporations. Those fraternities and sororities whose properties were not transferred to Colgate would cease to be recognized as campus organizations at Colgate as of the commencement of the 2005-06 academic year.

Over the course of the next eighteen months, BTP Corporation’s board of directors (the “BTP Board”) undertook an examination of Colgate’s new policy and its ramifications for the corporation and the local BTP chapter. This included discussions with members of Colgate’s administration as well as with the members of the boards of other Greek letter organizations at Colgate. BTP Board president Eric W. Will states in his affidavit that the board even considered commencing legal action against Colgate. In February, 2005, the BTP Board contacted each of the corporation’s 1,295 members in writing, stating its reluctant recommendation that the fraternity house should be sold to Colgate so as not to jeopardize the fraternity’s local existence, and seeking the members’ proxies. Approximately one-third of the members responded and, of them, more than 80% approved the board’s proposal.

In due course, the BTP Board and Colgate scheduled a closing to be held on May 26, 2005.¹ On the day before the transfer, plaintiff James Sanford caused to be delivered to the BTP Board his written demand that the sale not take place and a copy of a complaint that he proposed the BTP Board should file and serve challenging Colgate's residential policy. He advised the BTP Board that a members' derivative action would be commenced if his demands were not met.

Upon receipt of the demand, the BTP Board met to consider its contents. Among other things, it sought input from Board member Ralph A. Jones, an attorney admitted to practice in this State since 1957 with extensive employment experience with various colleges and universities. After deliberation, the board came to the conclusion that the litigation urged would have scant chance of success and that, on balance, the corporation's interests and the interests of the local BTP chapter would be better served by completing the sale to Colgate. Accordingly, the transfer closed as scheduled. BTP retains its recognized status at Colgate at this time.

This action was commenced in October, 2005, seeking, *inter alia*, the rescission of the sale of the fraternity house to Colgate, alleging that Colgate's actions were so heavy-handed, so one-sided and so oppressive that it was impossible for the BTP Board to exercise *any* judgment in the matter and that, as a result, the Board's actions were the result of coercion. Thus, plaintiffs argue, equity would demand that the sale be set aside.

Colgate seeks dismissal of the complaint under CPLR 3211 (a) (7) for failure to state a cause of action. Plaintiffs cross-move for leave to amend the complaint by naming and joining additional plaintiffs.

¹ With the transfer completed, BTP's status at Colgate would be preserved notwithstanding that the transfer date was approximately six months beyond the announced November 30, 2004 deadline.

As a general proposition, except for its routine day-to-day operations, a corporation acts through its duly elected board of directors. *See, for example*, N-PCL § 701 (a). Recognizing the authority statutorily vested in the board, courts are loathe to intervene in corporate affairs. Instead, courts follow the so-called “business judgment rule” which “bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.” *Auerbach v. Bennett*, 47 NY2d 619, 629 (1979). It is only in instances where the directors served conflicting or divided loyalties or where they otherwise failed to properly consider and evaluate the situation that the courts may be asked by the corporation’s members or shareholders to intervene. *Id.*

A shareholders’ or members’ derivative action involves a situation where the subject corporation has allegedly been twice wronged: in the first instance by some third party, and then by its own directors by their failure to take appropriate action. *Druckerman v. Harbord*, 174 Misc. 1077 (Sup Ct, New York County 1940). In the face of such allegations, the courts focus first on the decision or decisions of the directors.

... (T)he decision ... lies within the judgment and control of the corporation’s board of directors. Necessarily such decision must be predicated on the weighing and balancing of a variety of disparate considerations to reach a considered conclusion as to what course of action or inaction is best calculated to protect and advance the interests of the corporation. This is the essence of the responsibility and role of the board of directors, and courts may not intrude or interfere. *Auerbach v. Bennett, supra*, at 631.

The initial inquiry, then, is not *what* the directors decided to do but *how* the directors made their decision. So long as the directors acted in a manner consistent with their fiduciary duty, their decision will not be disturbed.

Recently, this Court dismissed the complaint in a remarkably similar case which was also

entitled *Sanford v. Colgate University* (hereinafter, "*Sanford I*"). That case involved the alumni corporation of Phi Delta Theta ("PDT"), another fraternity at Colgate which was seeking the rescission of the sale of its fraternity house to Colgate. Not only were the same attorneys involved in that action as are involved here, but the first-named plaintiff in *Sanford I* is the father of the first-named plaintiff in this action (hence, "*Sanford II*").

In *Sanford I*, the Court found that the plaintiffs had failed to allege the existence of any conflicts or division of loyalties affecting the PDT board of directors and further found that the board's evaluation of the issues before it was made with proper care, citing *Auerbach, supra*. The only substantial factual distinction between *Sanford I* and *Sanford II* is that in the former, the PDT Board sought the advice of an outside independent advisor, whereas in the latter, the BTP Board sought no outside advice. Plaintiffs have failed to cite any authority that would require a board to seek outside independent advice.

Here, BTP Board member Ralph A. Jones, Esq., according to his affidavit, has practiced law since 1957 and has spent most of his career as in-house counsel or in the administration of various universities in New York State. He personally investigated the circumstances of other colleges and universities in Central New York where fraternity housing was owned by the college or university. His findings, as reported to the BTP Board, were that the fraternities at those institutions were functioning acceptably.² He further avers that he had discussions with representatives of other fraternities at Colgate regarding litigation options that they were exploring. Therefore, it appears that

² The Court takes note of plaintiffs' allegations in the complaint that, of the 130 chapters of the fraternity throughout the United States and Canada, 73 have chapter-owned housing. This means that there are 57 chapters (43% of the total) functioning either in university-owned housing or with no housing at all.

the BTP Board, acting with unquestioned loyalty, made a reasonable inquiry and gave the matter a thorough and fair evaluation. Given that, and following this Court's reasoning in *Sanford I*, the complaint in this action must be dismissed.

Stated somewhat differently, there has been no allegation that the BTP Board was not fully aware of the matters vigorously advanced here by the plaintiffs, e. g., that Colgate University acted in so oppressive a manner that there was no equal bargaining position between it and the BTP Corporation, that the transfer agreement amounted to a contract of adhesion, that the circumstances permitted no exercise of free will, the devastating financial impact on the corporation if the local BTP chapter was not allowed to occupy the fraternity house, etc. No argument has been made that the BTP Board did not consider those points in the litigation it initially contemplated as well as the litigation later proposed by plaintiff James Sanford on May 25, 2005. Because the plaintiffs have made no allegation that the BTP Board was not aware of the existing circumstances and the arguments that might have been made, the Court cannot reach the conclusion that those issues were not fully and fairly evaluated. Thus, because the plaintiffs have failed to allege facts or otherwise demonstrate that the BTP Board wronged BTP Corporation, the Court has no reason to disturb the Board's decision, irrespective of the wisdom or folly of the decision itself.

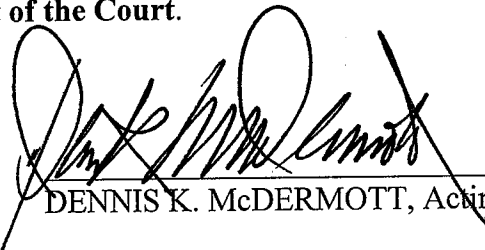
The foregoing ruling renders academic the plaintiffs' cross-motion to amend the complaint by joining additional plaintiffs. Originally, some 66 individuals were named as plaintiffs. No fewer than 65 were needed to meet the five percent requirement of N-PCL § 623 (a). Apparently, three of the persons named were not, in fact, members of the BTP corporation. Plaintiffs now seek to add ten more members to their side, raising their number to seventy-three. Were this Court to consider the cross-motion, it would be denied under N-PCL § 623 (b) which provides that " ... it shall be made

to appear that each plaintiff is such a member ... *at the time of bringing the action* (emphasis added).” The five percent figure is the minimum that must be met to confer standing upon the plaintiffs to proceed. Standing, being a threshold issue, is determined at the very outset of the case. *Society of Plastics Indus. v. County of Suffolk*, 77 NY2d 761 (1991); *Matter of Dairylea Coop. v. Walkley*, 38 NY2d 6 (1975). Because the individual plaintiffs were two short of the five percent necessary to satisfy the statutory requirement as of the commencement of this case, they have failed to demonstrate their standing to proceed. *Segal v. Powers*, 180 Misc.2d 57 (Sup Ct, New York County 1999).

The motion of the defendant to dismiss the complaint is granted. The cross-motion of the plaintiffs to amend the complaint is denied. Costs and disbursements are awarded to the defendant.

This Decision constitutes the Judgment of the Court.

Dated: March 3, 2006.



DENNIS K. McDERMOTT, Acting J.S.C.

The following papers are herewith filed in the office of the Madison County Clerk:

- Decision and Judgment
- Notice of Motion (December 15, 2005)
 - Affidavit of Eric W. Will
 - Affidavit of Edward R. Conan
 - Affirmation of Ralph A. Jones (fax copy only)
- Notice of Cross-Motion (with Affidavit of Kevin E. Hulslander)
- Memorandum of Law (Defendant)
- Memorandum of Law (Plaintiffs)
- Reply Memorandum (fax copy only)