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CasePrepPlus

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Summarizing recent significant New York appellate cases

Contracting parties beware. The Court of Appeals recently reaffirmed that parties to contracts, especially ones involving millions of dollars of investments, should closely read and understand their agreements, or they may suffer unintended consequences. That was exactly the case here, where the parties entered an oral investment agreement that would have let the investor take out the value of his membership interests in an LLC after five years, but was ultimately extinguished by a later merger clause in an amendment to the LLC's operating agreement. Is that harsh? Probably, but it's the consequence of the contractual language that the parties agreed to. Let's take a look at that opinion and what else has been happening in New York's appellate courts over the past week.

COURT OF APPEALS

CONTRACT LAW, MERGER CLAUSE

***Behler v Kai-Shing Tao*, 2025 NY Slip Op 00803 (Ct App Feb. 13, 2025)**

Issue: **Does a limited liability company agreement governed by Delaware law supersede, by operation of its merger clause, an alleged prior oral agreement between plaintiff and defendant?**

Facts: Defendant is the CEO of a publicly traded company, Remark, and the sole managing member of a Delaware LLC, Digipac, which he used to route investments to the publicly traded company. Defendant asked plaintiff to invest in Remark by investing in Digipac, but plaintiff was concerned about the inherent difficulty in exiting such an investment. So, the parties orally agreed to "provide an opportunity for plaintiff to exit the investment" in one of two ways: "(1) if Remark's share price hit $50, defendant would cause Digipac to sell its shares of Remark and distribute the proceeds (based on plaintiff's pro rata share of Digipac) to plaintiff; or (2) if the price of Remark shares never reached $50, defendant would provide plaintiff with an exit opportunity from Digipac based on the value of Digipac's Remark holdings on the fifth anniversary of plaintiff's initial investment." Plaintiff agreed and wired the investment to Digipac.

Following plaintiff's investment, defendant unilaterally amended the LLC agreement to govern "investment in Digipac, the liquidation of assets, distributions to members, and the transfer of membership interests," among other things. The amended LLC agreement provided it was governed by Delaware law and contained a merger clause that provided: "This Agreement, together with the Certificate of Formation, each Subscription Agreement and all related Exhibits and Schedules, constitutes the sole and entire agreement of the parties to this Agreement with respect to the subject matter contained herein and therein, and supersedes all prior and contemporaneous understandings, agreements, representations and warranties, both written and oral, with respect to such subject matter, including the Original Agreement."

Remark's share price never hit $50 per share, and on the fifth anniversary of plaintiff's investment, defendant did not provide plaintiff with an opportunity to exit Digipac. Plaintiff sued for breach of contract and promissory estoppel, seeking an order compelling defendant to purchase his Digipac interests for $11.6 million. Defendant moved to dismiss, arguing that any oral agreement was inconsistent with the amended LLC agreement and was extinguished by the merger clause. Supreme Court dismissed the complaint, and the Appellate Division, First Department affirmed, with two Justices dissenting.

Holding: The Court of Appeals affirmed, cautioning that "Delaware law unambiguously advises prospective investors in a closely held LLC (especially one considering a multimillion-dollar investment) to scrutinize the existing LLC agreement and condition their investment upon the clear written delineation thereunder of their contracted-for rights in the event of any future amendments to the LLC agreement." Here, the Court held, "[u]pon his initial investment, plaintiff became bound by the original LLC agreement, including its clause dictating how its terms could be altered. Once the agreement was altered pursuant to its terms, plaintiff became bound by the amended LLC agreement, including its merger clause." Under Delaware law, "a member of an LLC is bound by the limited liability company agreement whether or not the member executes the limited liability company agreement. Plaintiff, as a member of Digipac, is therefore bound by its operating LLC agreement—the amended LLC agreement—regardless of whether he signed it." Because the amended LLC agreement's merger clause "unambiguously and explicitly nullifies prior 'written and oral' agreements between the parties on the same subject matter," the Court held that the parties' prior oral agreement was extinguished.

ADMINISTRATIVE LAW, DISCRIMINATION

***Matter of Oceanview Home for Adults, Inc. v Zucker*, 2025 NY Slip Op 00805 (Ct App Feb. 13, 2025)**

Issue: **Do Department of Health regulations that provide that an adult home may not admit additional residents with serious mental illness if it has a capacity of 80 or more beds and its resident population is over 25% persons with serious mental illness facially violate the federal Fair Housing Act?**

Facts: The "Department of Health licenses certain facilities known as 'adult homes' to provide 'long-term care, room, board, housekeeping, personal care and supervision to five or more adults unrelated to the operator' (Dept of Health Regs [18 NYCRR] § 485.2 [b]). Regulations promulgated by DOH provide that an adult home may not admit additional residents with serious mental illness if it has a capacity of 80 or more beds and its resident population is over 25% persons with serious mental illness." These regulations were adopted, in large part, to comply with the United States Supreme Court's decision in *Olmstead v L.C. ex rel. Zimring*, in which the Court held that "the ADA imposes an affirmative obligation on the states to prevent the segregation of persons with disabilities in institutionalized settings that are more restrictive than appropriate for their needs." Following their adoption, the United States Department of Justice and a group of private plaintiffs challenged the regulations, arguing that the regulations continued to result in segregation of disabled persons in violation of the FHA. The parties reached a settlement of that litigation, which "referenced the new regulations and required the State to expand its supported housing capacity by at least 2,000 beds and take other affirmative steps to encourage the adoption of supported housing for persons with mental illness."

In 2016, DOH cited the plaintiff, an adult home subject to this admissions cap, for "admitting persons with serious mental illness in violation of the regulations." Plaintiff challenged the regulations, arguing that they "discriminate against persons with disabilities in violation of the Fair Housing Act Amendments of 1988 (FHAA), which extended the protections of the Fair Housing Act (FHA) to persons with disabilities." Supreme Court agreed, holding that the regulations violated the FHA because, "first, *Olmstead*'s integration mandate did not require them, and second, they were not narrowly tailored because alternative approaches, such as allowing persons with serious mental illness to make an 'informed choice' to live in transitional adult homes, were available." The Appellate Division, Third Department, however, reversed. Although agreeing that the challenged regulations were facially discriminatory, the Appellate Division held that they were permissible because they "had been adopted to implement *Olmstead*'s integration mandate and were narrowly tailored." The Appellate Division gave great weight to the State's experts' testimony that "that transitional adult homes are not beneficial to recovery for people with serious mental illness and that smaller facilities are beneficial to the recovery of people with serious mental illness" and, thus, upheld the regulations.

Holding: The Court of Appeals affirmed, holding that the plaintiff had not demonstrated that the regulations were facially invalid because they do not "deny" or "make unavailable" housing on the basis of a person's disability. The Court reasoned, "the admissions cap reflects a professional judgment about what settings are clinically and therapeutically effective for persons with serious mental illness. By giving those individuals greater ability to exercise autonomy and interact with individuals who do not have serious mental illness, the regulations further the goal of ending unnecessary exclusion of persons with disabilities." Thus, "the admissions cap reflects a reasonable modification to the State's provision of services intended to eliminate discrimination against persons with disabilities." Finally, the Court held, because no evidence existed that "the admissions cap rests on stereotypes, prejudice, or fear about persons with serious mental illness," rather than the independent medical judgment of DOH officials regarding how best to treat those with serious mental illness, the regulations did not facially violate the FHA.

FIRST DEPARTMENT

LANDLORD-TENANT, YELLOWSTONE INJUNCTIONS

***Wharton-Bickley v 388 Broadway Owners LLC*, 2025 NY Slip Op 00802 (1st Dept Feb. 11, 2025)**

Issue: **Can a trial court's refusal to grant a temporary restraining order, which resulted in the running of the cure period and termination of the lease while the plaintiff's Yellowstone injunction motion was pending, deny plaintiffs the opportunity to obtain the ultimate Yellowstone injunctive relief sought?**

Facts: "Defendant is the owner and landlord of the building located at 388 Broadway in Manhattan. The building is an interim multiple dwelling." The plaintiffs signed a commercial lease for a unit in the building for a "live/work office space" and then began to reside in it. In April 2023, defendant served a default notice on plaintiffs, alleging that they used the unit to run a cabaret, permitted garbage to accumulate outside the unit, and built interior walls without its consent. The notice provided that the "alleged defaults had to be cured on or before May 19, 2023, or the lease would be terminated as of May 31, 2023."

One day before the cure period was to expire, plaintiffs filed this action and sought, by order to show cause, a *Yellowstone* injunction to prevent the expiration of the cure period and termination of the lease. The order to show cause contained a temporary restraining order clause, which Supreme Court struck out before signing the order. "The court gave no explanation for this critical action, which allowed the cure period to lapse. With the cure period exhausted, defendant terminated the lease as of May 31, 2023. Defendant thereafter opposed the motion, arguing that plaintiffs failed to demonstrate that they held a commercial lease; rather, they were personal guarantors of the

lease. Defendant also argued that plaintiffs did not establish a good faith intent or ability to cure the lease defaults. Defendant posited that the cure period had lapsed and the lease was terminated, which prevented the court from granting Yellowstone relief."

Supreme Court denied the *Yellowstone* injunction, determining: "First, the protections afforded by a *Yellowstone* injunction are generally reserved for commercial tenants. Here, by plaintiffs' own admission, the premises involved is under renewed registration as a dwelling and plaintiffs' own Loft Board application for Protected Occupancy Status confirms their desire to have it so. Second — and even were this court prepared to view the premises as a commercial unit for *Yellowstone* purposes — an essential element of *Yellowstone* injunctive relief is a tenant's manifest commitment to cure the defaults noticed in the landlord's notice of default. Nothing is found in the record the present record to convince the court of such a commitment."

Holding: The First Department reversed, explaining that "the *Yellowstone* injunction tolls the relevant cure period, thereby preventing the termination of the lease. With the *Yellowstone* injunction in place, the tenant can litigate with some confidence: if the tenant prevails in the underlying dispute with the landlord, the tenant walks away from the litigation with the lease intact; if the tenant loses the underlying dispute, the tenant can cure the demonstrated lease defaults before the expiration of the remaining cure period." The Court noted, "[t]he party seeking *Yellowstone* relief must demonstrate the following four elements: (1) It holds a commercial lease; (2) it received from the landlord either a notice of default, a notice to cure, or a threat of termination of the lease; (3) it requested injunctive relief prior to the termination of the lease; and (4) it is prepared and maintains the ability to cure the alleged default by any means short of vacating the premises."

Although the plaintiffs averred that they were residential tenants, but held that tenancy through a commercial lease required by defendant, the Court decided that the nature of the tenancy under the first element was ambiguous enough to "err on the side of caution in determining whether a plaintiff qualifies to seek" a *Yellowstone* injunction at this preliminary stage of the action. Second, the Court held, Supreme Court's "seemingly uncommon move" of striking the TRO clause from the order to show cause should not bar Plaintiffs' request for relief under the third element, because Plaintiffs sought that relief before the cure period expired and complied with the spirit of the *Yellowstone* requirement. The Court explained, "we agree with the Second Department's observation . . . that 'the Yellowstone rule is equitable in nature, and in equity the erroneous denial of a timely sought temporary toll or the inadvertent failure to continue one already granted, should not result in the forfeiture of a leasehold'. Moreover, both our Court and the Second Department have encountered the precise situation we face here: Supreme Court's striking of a plaintiff's request for *Yellowstone* TRO relief, leading to the expiration of the cure period, and the termination of the lease. In those rare instances, our Court and the Second Department, upon finding that TRO relief was timely sought and erroneously denied, afforded the plaintiffs injunctive relief *nunc pro tunc* as of the date of the order to show cause, thereby preserving the plaintiffs' substantial property interests in their leases. We note, too, that the situation encountered by plaintiffs the unexplained denial of TRO relief in aid of a timely submitted application for a *Yellowstone* injunction is akin to an 'improper action by a court' and 'judicial inadvertence,' which we have recognized justifies *nunc pro tunc* effect for Yellowstone relief." Finally, the Court held that the Plaintiffs' affidavit in support sufficiently demonstrated that they were not in default and otherwise intended to cure any default ultimately adjudicated by the Court. Thus, the First Department held that the *Yellowstone* should have been granted, and did so *nunc pro tunc* to the time that Plaintiffs' made the application, one day before the cure period expired.

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