Belkin • Burden • Goldman, LLP
BBG UPDATE

SPRING 2021 | VOL 58

EDITORS
Robert A. Jacobs
Kara I. Rakowski
Aaron Shmulewitz

Inside This Issue

In A Boon For Commercial Landlords, Recent Court Decisions Reject Tenant Covid-19 Related Defenses

BY ISRAEL A. KATZ

In the wake of the Covid-19 pandemic and corresponding government-mandated shutdowns, many commercial tenants falling behind in rent payments have sought to rescind their lease obligations and avoid making payment by invoking the common law doctrines of impossibility and frustration of purpose. This article will examine the various arguments being raised by tenants and discuss the apparent recent trend developing in New York, in which Courts are rejecting tenant claims. Notably, recent decisions do not appear to differentiate between types of commercial establishments–Courts continue to enforce lease obligations of gyms, commercial office spaces, restaurants and retail spaces alike, adopting broad readings of express lease provisions to continue to enforce tenant rental obligations.

I. Commercial Tenant Arguments

A. Impossibility

One argument being raised by commercial tenants is the common law doctrine of impossibility. That is, the Covid-19 shutdowns have made performance of a lease impossible, which discharges a tenant's obligation to perform. Under New York law, the doctrine of impossibility "excuses a party's performance of a contract when the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract." *Kel Kim Corp. v. Central Markets, Inc.* 70 N.Y. 2d 900 (1987).

CONTINUED ON PAGE 2

CONTINUED FROM PAGE 1

Commercial tenants that invoke this theory are claiming that government shutdowns due to the pandemic were an objectively unforeseeable event at the time of the execution of the lease, which has rendered their contractual performance impossible because they could not conduct business out of their space.

B. Frustration of Purpose

Another common and similar argument is the frustration of purpose doctrine. Under New York law, "[i]n order to invoke the doctrine of frustration of purpose, the frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense" *In Center for Specialty Care, Inc. v CSC Acquisition I, LLC*, 185 AD3d 34, 42 (1st Dept. 2020). However, the application has been "limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party." *United States v Gen. Douglas MacArthur Senior Vill., Inc.*, 508 F2d 377, 381 (2d Cir. 1974) (citing *Alfred Marks Realty Co. v Hotel Hermitage Co.*, 170 AD 484, 485 [2nd Dept. 1915]).

Under this theory, commercial tenants are asserting that the ability to open and operate a business is the principal purpose of a commercial lease and, as a result of government shutdowns, this purpose was frustrated, thereby discharging the tenants from their lease obligations. Frustration of purpose is different from the defense of impossibility because it does not require that the tenant show that it cannot comply with the terms of the lease. In other words, even in a situation where a commercial tenant has substantial assets and the ability to pay rent, it may invoke this argument in order to discharge its rental obligations under the lease.

II. Recent Decisions

Recent decisions issued by New York Courts have resoundingly rejected frustration of purpose and impossibility arguments raised by commercial tenants seeking to avoid their lease obligations.

- *A. BKNY1, Inc. d/b/a 132 Lounge v. 12 Capulet Holdings, LLC*

  In this case, tenant BKNY1 failed to pay rent for the months of April and May 2020 because of the mandatory closure of its restaurant during those months. Tenant argued that the doctrines of frustration of purpose and impossibility discharged its rental obligations. Rejecting these arguments, Justice Lawrence Knipel of Supreme Court, Kings County Commercial Division ruled that the doctrine of frustration of purpose does not apply because "impossibility occasioned by financial hardship does not excuse performance of a contract." *BKNY1, Inc. d/b/a 132 Lounge v. 12 Capulet Holdings, LLC*, Index Number 508647/2016, NYSCEF Doc No. 588,*3 (Sup. Ct. Kings County, October 5, 2020). The Court reasoned that inasmuch as the lease term was for approximately nine years, a "temporary closure for two months could not have frustrated its overall purpose" *Id.* The Court also rejected tenant's impossibility argument, by broadly interpreting the lease and noting that "nothing in the Lease permits termination or suspension of tenant's obligations to pay rent in the event of a government order restricting the use of the leased premises." To the contrary, the "Lease provides that plaintiff's obligations to pay rent 'shall in no wise be affected, impaired or excused because Owner is unable to fulfill any of its obligations under this lease. . . by reason of. . . . government preemption or restriction'" *Id.* at 4. Consequently, the Court ordered tenant to pay rent within 30 days or risk the Court vacating a prior injunction that had prevented landlord from terminating the lease. *Id.* at 5.

B. Dr. Smood New York LLC f/k/a Dr. Smood Orchard LLC v. Orchard Houston, LLC,

In another restaurant case, the tenant sought a preliminary injunction prohibiting the landlord from drawing down on the security deposit based upon non-payment of rent. In denying tenant's motion and tenant's frustration of purpose argument, the Court noted:

> *for a party to avail itself of the frustration of purpose defense, there must be complete destruction of the basis of the underlying contract; partial frustration such as a diminution in business, where a tenant could continue to use the premises for an intended purpose, is insufficient to establish the defense as a matter of law.*

Dr. Smood New York LLC f/k/a Dr. Smood Orchard LLC v. Orchard Houston, LLC, 2020 NY Slip Op 33707(U) *4 (Sup. Ct. NY Co. November 2, 2020).

Specifically, the Court noted that the premises remained open for both countertop and pickup of orders submitted online, and the government prohibition against indoor dining alone did not rise to the level of frustration of purpose necessary to absolve tenant of its rent obligations under the lease.

C. 1140 Broadway LLC v. Bold Food, LLC, KBFK Restaurant Corp.

In this case, a restaurant consulting business, which leased office space on the twelfth floor in an office building, sought to circumvent its rental obligations by arguing that its lease for the office space was rescinded under the frustration of purpose and impossibility doctrines because the business was devastated by the Covid-19 pandemic. The tenant

CONTINUED ON PAGE 3

CONTINUED FROM PAGE 2

argued that its primary services involved managing and consulting for a group of restaurants, and that the government shutdowns of restaurants rendered its business unprofitable. Justice Arlene Bluth rejected the tenant's arguments and granted summary judgment to the landlord. As to frustration of purpose, the Court found the doctrine to be a narrow one and that "it does not apply here, where the tenant rented office space, the tenant's industry experiences a precipitous downfall and tenant could no longer pay rent." *1140 Broadway LLC v. Bold Food, LLC, KBFK Restaurant Corp.*, Index Number 652674/2020, NYSCEF Doc No. 30, *3 (Sup. Ct. NY Co. December 3, 2020). As to impossibility, Justice Bluth wrote:

> *It is critical to point out that the tenant merely provided restaurants with consulting services. It was not shut down by any public health directives. In other words, the tenant was one step removed from the governor's public health orders relating to restaurants because their business assists restaurants. It appears that restaurants no longer needed assistance with human resources, payroll or accounting, not because of anything plaintiff did (or failed to do). Sometimes that happens in business—an industry changes overnight.*

Id. at 4.

Accordingly, the Court refused to excuse the tenant from its rent obligations and granted summary judgment to the landlord as to liability.

D. 35 East 75th Street Corporation v. Christian Louboutin L.L.C.

In another opinion authored by Justice Bluth, retail tenant Christian Louboutin argued that the ongoing pandemic implicated the doctrines of impossibility and frustration of purpose absolving it of its obligations under the lease because the lack of customer traffic on the Upper East Side decimated its business. *35 East 75th Street Corporation v. Christian Louboutin L.L.C.*, 2020 Slip Op. 34063(U),*1 (Supreme Court, New York County, December 9, 2020). Rejecting the tenant's arguments, Justice Bluth ruled that because the lease space still existed and Louboutin was never prohibited from selling its products, that did "not permit the Court to simply rip up a contract signed between two sophisticated parties." *Id.* at 4. The Court therefore entered summary judgment in favor of the landlord awarding a judgment for more than $1.6 million, in fixed and additional rent due under the lease. (BBG represented the successful landlord, a co-op.)

E. Cab Bedford LLC v Equinox Bedford Ave, Inc.

In a third consistent opinion authored by Justice Bluth, this time, in connection with Equinox Gym, Equinox argued that government shutdowns frustrated the purpose of its lease to operate as a gym and therefore the lease should not be enforced. The Court rejected the tenant's argument and entered summary judgment in favor of the landlord. The Court determined that frustration of purpose did not apply because "[a] gym being forced to shut down for a few months does not invalidate obligations in a fifteen-year lease." *Cab Bedford LLC v Equinox Bedford Ave, Inc.*, 2020 NY Slip Op 34296(U), (Sup. Ct. NY Co. December 22, 2020). Similarly, the Court held the doctrine of impossibility inapplicable because the subject matter of the lease was not destroyed–"At best it was temporarily hindered." *Id.*

F. Victoria's Secret, LLC v. Herald Square Owner LLC

Finally, on January 7, 2021, Justice Andrew Borrok of New York County's Commercial Division entered summary judgment against retail tenant Victoria's Secret, finding that it could not invoke the doctrines of impossibility or frustration of purpose to avoid rental obligations or rescind the lease of its New York store. See *Victoria's Secret, LLC v. Herald Square Owner LLC*, Index No. 651833/2020, NYSCEF No. 47 (NY Sup. Ct. Jan. 7, 2021). Justice Borrok rejected the tenant's argument that it only assumed the risk of temporary store closures, not massive government-ordered shutdowns in the face of a deadly pandemic. Instead, adopting a broad interpretation of the lease, the Court held that the lease provision allocating the risk of a store closure by State law to the tenant included pandemic-caused store closures, thereby obligating the tenant to continue to pay rent.

Conclusion

These recent cases demonstrate the recent trend developing under New York case law. No matter the type of commercial establishment, Courts have consistently found tenants of commercial leases to have assumed the risk of pandemic-based government shutdowns, and are enforcing commercial leases according to their terms. Invariably, this trend will afford commercial landlords considerable leverage when negotiating modifications, restructuring or rent abatements with their commercial tenants.

Israel A. Katz is an associate in the Firm's Litigation Department, and can be reached at 212-867-4466 ext.824, or at ***ikatz@bbgllp.com****.*

Constitutional Challenge to the Rent Stabilization Law

BY MAGDA L. CRUZ

In July, 2019, shortly after the passage of the Housing Stability and Tenant Protection Act of 2019 (the "HSTPA"), real estate industry organizations and private property owners sued the City of New York, the Commissioner of the New York State Division of Housing and Community Renewal, and the Rent Guidelines Board and its members, in Federal District Court for the Eastern District of New York. The action, entitled *Community Housing Improvement Program, et al. v. City of New York, et al.* (19-cv-4087), challenged the constitutionality of the Rent Stabilization Law, together with the sweeping amendments that the HSTPA made to the RSL, on their face. The action was dismissed by the District Court on September 30, 2020, on the ground that "[n]o precedent binding on this Court has ever found any provision of a rent-stabilization statute to violate the Constitution, and even if the 2019 amendments go beyond prior regulations, 'it is not for a lower court to reverse this tide'… at least in response to the instant facial challenges." The decision is presently pending appeal before the U.S. Court of Appeals for the Second Circuit.

The suit contends that the justifications given by lawmakers for the RSL and its HSTPA amendments to extensively regulate virtually every aspect of private rental housing are predicated upon a seemingly endless housing "emergency" that the RSL has, and continues to, exacerbate. The suit maintains that the wide-ranging restrictions in the RSL, as amended, contribute to the "acute shortage of housing accommodations," defined in the law as "a vacancy rate of 5% or less" – which has lasted for half a century – because it strongly undermines housing development. The RSL, especially as amended by the HSTPA, places enormous burdens on property owners, substantially diminishes the value of their buildings, and arbitrarily limits the ability to generate rental income without regard to ever-increasing costs of operating and maintaining rent regulated buildings. The contentions by lawmakers that the restrictions imposed by the RSL, as amended, are necessary in order to maintain housing affordable to low-income renters, reduce homelessness, and preserve racial and socio-economic diversity in the City, are not well-founded.

The complaint sets out, in detail, how the RSL has no provision targeting benefits to low-income households, preventing homelessness, or promoting diversity. Instead, reputable, independent studies show that the RSL depresses rental housing, which results in reduced property tax revenue for the City — revenue that might be used to fund alternative government programs that could actually advance housing initiatives, like direct subsidies to low-income tenants, improvements to public housing, and affordable housing and supported housing construction projects.

The incongruence between the stated goals of the RSL and its actual, documented, effect for half a century, demonstrates that the RSL's substantial infringement upon private property rights has no rational basis. Federal and New York State law hold that government regulation of private property must have a reasonable nexus between the regulation and a legitimate public purpose. The plaintiffs in the suit argue that the absence of a rational basis, made even more acute by the HSTPA, renders the RSL, as amended, unconstitutional on its face.

In addition, the owners challenge the RSL as an unconstitutional physical taking of property without just compensation in violation of the Takings Clause of the Fifth Amendment to the U.S. Constitution. Specifically, the RSL, as amended, erodes owners' fundamental rights to control their property, such as the right to exclude others from their property and to possess, use, and dispose of their property. The RSL has ever-expanding requirements to grant leases to successors, who are often complete strangers to the owners; severe restrictions on recovery of units for personal owner use; and severe restrictions on converting rental housing to other lawful uses, among many other restrictions. The owners allege that these restrictions, and many other mandates, force a subset of private property owners in New York to provide a public assistance benefit without just compensation, which should be undertaken by the public at large. This violates a basic tenet of the Takings Clause, which prohibits government from forcing some people alone to bear public burdens.

The owners also challenge the RSL as an uncompensated regulatory taking of private property, further violating the Constitution's Takings Clause. Their complaint details how the RSL, as amended, has now gone so far in infringing upon owners' reasonable investment-backed expectations that it can no longer pass constitutional muster as simply benign economic regulation that need not be compensated by the government.

Aside from the documented diminution in property value that the RSL causes to buildings by reason of, *inter alia*, mandating below-market rents that are insufficient to cover basic operating and maintenance costs, the HSTPA amendments imposed further restrictions on recovering the cost

CONTINUED ON PAGE 5

CONTINUED FROM PAGE 4

of improvements after (a) a tenant vacates an apartment, and (b) building-wide major capital improvements are performed. The restrictions are so severe that they bear no relationship to the actual costs of the improvements and have recovery timeframes that are so far out into the future that they completely disincentivize capital investment in regulated rental housing.

Facial Challenge to the RSL, as amended by the HSTPA, will be Reviewed on Appeal

The Second Circuit will consider whether, notwithstanding past decisions upholding the constitutionality of various provisions of the RSL against facial challenges, the RSL, as amended, has now become so onerous, invasive and destructive of owners' core property rights, that it has transcended constitutional limits. In the appeal, the appellant-owners will seek to establish that the complaint's allegations sufficiently support legally cognizable due process and takings claims so that they may have the opportunity to prove their claims at a trial on the merits, and enjoin further infringements on property rights in the realm of New York City regulated rental housing.

Magda L. Cruz is a partner of the Firm specializing in appellate practice. She and Sherwin Belkin represent the Real Estate Board of New York, one of the amici curiae in this appeal. Ms. Cruz can be reached at 212-867-4466 ext. 326, or at ***mcruz@bbgllp.com****.*

Current Challenges Facing Commercial Landlords After One Year of the Covid-19 Pandemic

BY LEWIS A. LINDENBERG

Where to Bring Commercial Rent Collection Cases - Civil Court Summary Proceedings or Supreme Court Plenary Actions

As we approach the one-year anniversary of the Covid-19 pandemic, most commercial real estate owners continue to be frustrated due to events impeding their ability to collect rent from their tenants. During the past year, Governor Cuomo signed executive orders, the New York State legislature enacted laws, and the Courts were closed–either wholly or partially–effectively eliminating the ability of commercial owners to obtain payment of rent or tenants' evictions, other than through voluntary means.

The governmental measures have prohibited commercial owners from seeking tenants' evictions.

With limited options, owners have attempted to negotiate agreements with tenants including many varied repayment options. This has often not proven successful for the owners. Whether tenants have had genuine need or have taken advantage of the situation, owners have had very few avenues to pursue for rent collection. While governmental financial assistance has been made available to tenants, the same cannot necessarily be said for owners. This article will discuss the current status of recent legislation enacted to stay eviction proceedings, so as to provide commercial owners with the best legal options to pursue tenants who refuse to pay their rent.

Our review will compare the owners' option to either continue to wait for an undefined future date to commence a summary proceeding in the Civil Court, or to immediately commence a plenary action in the Supreme Court. Our analysis suggests that, given current circumstances, owners should consider commencing a plenary action now in Supreme Court for the collection of rent, against the tenant and any guarantor. We also anticipate that, once all the legislative bars on evictions are removed, owners will be able to obtain legal possession by asserting claims for ejectment in any such Supreme Court action.

Executive Orders, New York State Legislation and Civil Court

Over the course of the last year, many executive orders have been signed to deal with many issues arising from the pandemic. The most recent executive order (***Executive Order No.202.97)*** signed by Governor Cuomo continues through April 16, 2021 the current moratorium on the initiation of non-payment proceedings against, or the enforcement of an eviction of, any commercial tenant who is eligible for unemployment insurance or benefits under state or federal law, or who is otherwise facing financial hardship due to the pandemic. It is noteworthy that only summary non-payment proceedings in

CONTINUED ON PAGE 6

CONTINUED FROM PAGE 5

Civil Court are affected by EO 202.97, and that owners may pursue rent collection in plenary actions in Supreme Court.

Whether or not EO No. 202.97 is extended beyond March 28, the New York State Senate recently passed legislation to protect small businesses that are struggling due to the pandemic from the threat of foreclosure or *eviction* ***until May 1, 2021***. The bill is entitled *"COVID-19 Emergency Protect Our Small Businesses Act of 2021."* The bill provides a mechanism for eviction protection for small businesses of fewer than 50 employees that demonstrate a financial hardship, while also extending foreclosure protections to certain small businesses. This law only stays eviction proceedings and does not impact the ability of owners to pursue rent in a Supreme Court action.

Summary Proceedings–Previously

It is worth mentioning that, before the pandemic, a summary proceeding in the commercial part of Civil Court was generally the most expeditious means to obtain a money judgment and accomplish a tenant's eviction–the owner could expeditiously and effectively obtain a monetary and a possessory judgment; if the monetary judgment was not paid, the tenant would be evicted. The owner would attempt to relet the premises while the tenant remained responsible for the rent pursuant to the lease even after the tenant was evicted. These multiple remedies against a tenant served as very strong incentives for tenants to comply with their lease obligations.

Summary Proceedings–Prospectively

Currently, the Civil Court is only beginning to open with many fewer Court personnel. (Only matters not involving the collection of rent and evictions are being conducted remotely.) Executive orders and State laws staying commercial eviction cases will eventually be lifted, and filings of new commercial non-payment proceedings will start to be accepted. Currently, there is one year's worth of non-payment cases waiting to be filed with the Court. Matters filed before March, 2020 will take priority. The Civil Court has historically been one of the busiest Courts in the State. The ability to resolve matters "in the hallway" used to be standard operating procedure, and was a crucial part of how cases were resolved quickly. Clearly, it will be a long time, if ever, for any large-scale ability to resolve matters "in the hallways". The huge backlog of cases will also contribute to delay in the issuance of judgments and warrants of eviction. Additionally, guarantors (whether "full guarantors" or "good guy guarantors") will not be subject to inclusion in Civil Court summary proceedings seeking eviction.

Thus, there is currently a significant advantage to bringing a Supreme Court plenary action for the collection of rent and other amounts due. There are no moratoriums or stays in effect to bar such an action for rent (although asserting a claim for ejectment now would violate EO 202.97 as well as the Small Businesses Act of 2021), and being able to also pursue a guarantor in a Supreme Court plenary action is a distinct added advantage.

As discussed more fully in an article by my colleague Israel Katz in an article that appears elsewhere in this newsletter, there has been a recent series of Supreme Court case decisions favorable to commercial owners, and rejecting commercial tenants' pandemic-based defenses.

Courts have been willing to grant summary judgment to owners, thus avoiding a trial and affording owners quick relief. In *35 East 75th Street Corporation v. Christian Louboutin L.L.C.*, in which I represented the owner, the Supreme Court dismissed all of the tenant's defenses and awarded the owner a money judgment in excess of $1.6 million. The Court accepted our summary judgment motion papers on a Monday and issued its decision that Friday.

Conclusion

The moratorium on eviction proceedings will eventually be lifted and life will resume. However, in the meantime, commercial owners should strongly consider bringing a Supreme Court plenary action for rent against the tenant and any guarantor.

Lewis A. Lindenberg is a partner in the firm's Litigation Department concentrating in commercial litigation matters, and can be reached at 212-867-4466 ext. 335, or at ***llindenberg@bbgllp.com****.*

Better Read Than Lead

BY ORIE SHAPIRO

Owners' obligations to remediate lead in certain residential buildings have grown exponentially in recent years. A number of the regulations were promulgated and/or took effect while much of our attention was focused on the Covid pandemic. This article, which is based on information from the New York City Department of Housing Preservation & Development ("HPD") and other sources, will summarize some of the newer requirements in an effort to lead owners on the path to compliance.

Annual Obligations

Owners of multiple dwellings (and certain other residential buildings discussed below) built prior to 1960 (or between 1960 and 1978, if the owner has knowledge that there is lead-based paint) must send an *Annual Notice* to each tenant to determine if a child under six lives (or routinely spends 10 or more hours a week) in a dwelling unit. The notice should be sent in the first two weeks of each calendar year and the completed response must be collected by February 15 and retained by the owner.

If a tenant does not return the completed notice by February 15, the owner must conduct *follow-up inspections* between February 16 and March 1 to determine if a child under six lives in the dwelling unit. The owner should keep records of its attempts to contact the tenant to perform the inspections.

Assuming an owner: a) does not receive the completed notice from the tenant and b) cannot determine based upon the follow-up inspections whether a child under six lives in the unit, the owner must notify the Department of Health and Mental Hygiene ("DOHMH") in writing that it did not receive the completed notice from the tenant. The owner should use prescribed HPD forms to document its efforts.

An owner must perform a *visual inspection* of any unit in which children (as defined above) reside, to look for potential lead-based paint hazards. These hazards include: peeling paint, chewable surfaces (such as window sills), deteriorated subsurfaces, friction surfaces (painted doors or windows) and impact surfaces. The investigation must encompass every surface in every room in the dwelling unit, including the interiors of closets and cabinets. The owner should record the investigation findings on the appropriate HPD form and provide a copy of the inspection results to the tenant.

The owner must also do this visual inspection in any common areas (such as a lobby, hallway, or stairwell) of the building where a child resides.

The owner must assume that peeling paint found on a surface is lead paint and must retain an appropriately certified contractor to complete the remediation/repairs safely and quickly; and maintain all documents regarding contractor work.

If an owner believes there is no lead in the paint, the owner may hire a certified contractor to test the peeling paint and keep documented evidence that the painted surface does not have lead.

Turnover Obligations

Before a new tenant moves into an apartment, owners are required under HPD regulations to take the following steps, regardless of whether the new tenant has a child living with them at the time of initial occupancy.

1. Remediate all lead-based paint hazards and any underlying defects. At a minimum, remediation requires wet scraping and painting.
2. Remove lead-based paint on:
    a. "chewable surfaces" or encapsulate the surface with a hard, puncture-resistant encapsulant;
    b. friction all doors and door frames surfaces;
    c. friction all window surfaces or provide for the installation of replacement window channels or sliders on the friction surface.; and
3. Make all bare floors, window sills, and window wells in the dwelling unit smooth and cleanable.

The "turnover" work must be done by an appropriately certified contractor. Owners must then certify compliance with the turnover requirements on the *Lease/ Commencement of Occupancy Notice for Prevention of Lead Paint Hazards*, which must be provided (along with a DOHMH pamphlet) to the new tenant. This notice is also required at lease renewal.

New Test Requirement For All Tenant-Occupied Units

Owners are now required to test (with X-Ray Fluorescence (XRF)) all residential tenant-occupied rental units in buildings built before 1960 for the presence of lead-based paint. The tests must be conducted by an independent EPA-certified inspector or risk assessor. The tests must be completed by August, 2025, unless a child under six starts to reside in a unit, in which event the testing must be done within one year or by the August, 2025 deadline, whichever is sooner. *If a child under six currently resides in a unit, an XRF test must be completed for that unit by August 9, 2021.* An owner must provide the tenant with the results of the testing. As with other provisions discussed above, the testing requirement also applies to rental buildings constructed between 1960 and 1978 if the owner has actual knowledge of lead-based paint.

CONTINUED ON PAGE 8

CONTINUED FROM PAGE 7

Owner May Apply For Exemption

As noted above, paint in buildings with three or more residential units built prior to January 1, 1960 where a child under the age of six lives is presumed to be lead-based paint. A property owner can apply for an exemption from performing annual notices and inspections and turnover work. The application requires specific documentation demonstrating that the apartment unit or building is free of lead-based paint, or has been made free of lead-based paint through permanent removal, or has been made lead-safe using approved containment and/or encapsulation materials. Upon turnover, the owner must apply for a new exemption.

Expansion Of The Definition Of Multiple Dwelling In The Lead Context

Landlords of smaller buildings and vacation rental owners now also need to comply with lead inspection requirements. *As of February, 2021, these regulations also apply to tenant-occupied, one- and two-unit buildings.*

Co-Ops And Condos

If a condo or co-op dwelling unit is occupied by the owner or the owner's family, most of these requirements do not apply. However, the rules can be triggered if a dwelling unit is occupied by a tenant, whether of the sponsor or the apartment owner.

Note On Enforcement

HPD is now statutorily required to audit a minimum of 200 buildings per year for records of compliance with lead paint regulations. Responding to HPD Record Production Orders requires assembling records dating back 10 years, including, among other things, the documentation discussed above.

HPD may now issue violations for abatement at turnover if an inspection shows presence of lead paint and the apartment has been turned over since August, 2004. This violation may be corrected by abating the condition and providing documentation to HPD.

Conclusion

This article should be regarded as an overview of ever-expanding owner obligations in this area. We cannot stress enough the importance of compliance with these regulations and maintaining exhaustive records of such compliance. Owners must retain the records of their efforts for at least a decade and certify compliance with these requirements as a part of the annual property registration. Familiarity with these regulations could lead the reader to maintaining a safe building while minimizing potential liability.

Orie Shapiro is a partner in the Firm's Administrative Department, and can be reached at 212-867-4466 ext. 347, or at ***oshapiro@bbgllp.com****.*

Regulated Reconfiguration – How to Charge a First Rent

BY LOGAN J. O'CONNOR

Following enactment of the Housing Stability and Tenant Protection Act ("HSTPA") in June, 2019, owners of rent-regulated buildings were left with few opportunities to increase legal regulated rents. The HSTPA abolished vacancy rent increases (unless specifically authorized by the Rent Guidelines Board) and drastically limited individual apartment improvement ("IAI") rent increases to temporary increases for no more than $15,000 per apartment.

Furthermore, owners may no longer deregulate apartments by virtue of the high rent vacancy deregulation method, widely known as "luxury" deregulation.

However, one method for creating considerable rent increases survived – apartment reconfiguration. Pursuant to Rent Stabilization Code ("RSC") § 2520.11(r), where an owner has substantially altered the perimeter walls of an apartment so much so that the old apartment essentially ceases to exist, a first rent may be charged for the "newly created unit." The apartment will remain rent stabilized but the rent may be significantly increased and should accurately reflect the value added by reconfiguration. Any legal rent increases thereafter will be based upon such newly established higher first rent.

The theory behind this "first rent" mechanism is that where a newly created apartment is unrecognizable in comparison to its previous configuration, the previous apartment's rent history becomes meaningless and a new rent must be established.

Typically, reconfiguration occurs when a two-bedroom apartment is split into two one-bedroom apartments or studios, or where two smaller apartments are

CONTINUED ON PAGE 9

CONTINUED FROM PAGE 8

consolidated to form one large apartment. Courts have clarified that minor "enlargement" of an existing apartment without extensive rehabilitation or reconfiguration will not be sufficient to justify a first rent.

Notwithstanding the foregoing, it is unclear how long this method will go unchallenged. The DHCR is presently considering establishment of a policy that would define precise requirements for a newly created unit. We do not yet know when, if, or how this may occur, or if such a policy would be applied retroactively. Please consult BBG to discuss this issue.

Logan O'Connor is an associate in BBG's Administrative Department, and can be reached at 212-867-4466 ext. 365, or at ***loconnor@bbgllp.com****.*

New State Law Requires Disclosure of Disability Accommodation Rights—and, Yes, it's Applicable to Co-ops and Leased Condo Units

BY AARON SHMULEWITZ

New York State Executive Law section 296.18-a went into effect on March 2, and requires that "every owner, lessee, sub-lessee, assignee, or managing agent of, or other person having the right of ownership of, or possession of, or the right to rent or lease, housing accommodations" must notify in writing all tenants and prospective tenants of their right to request reasonable modifications and accommodations if they have a disability. Such notice was to be given to existing tenants by April 1, 2021, but initial implementation is now being delayed for administrative reasons; going forward, such notice is to be given to new tenants within 30 days of the beginning of their tenancy. The notice is also to be posted on every vacant apartment that is offered for rent. The New York State Division of Human Rights has promulgated a sample form of notice, which can be accessed **here**.

The statute is written broadly enough that it applies to co-ops and their managing agents, who should now make the notice part of their standard purchase and sublease packages (much like the bedbug and sprinkler notices have now become part of these packages). Further, the statute would also apply to unit owners of condominium apartments that are leased out. The managing agents of such condominiums should ensure that the new disability accommodations notice is now included in the leasing package for such condominium units as well.

Aaron Shmulewitz heads the Firm's co-op/condo practice, and can be reached at ***ashmulewitz@bbgllp.com****, or 212-867-4466, ext. 390.*

Court Affirms Rights of Co-op Holders of Unsold Shares But Unwittingly Opens Pandora's Box

BY AARON SHMULEWITZ

A recent appellate Court decision has given co-op Holders of Unsold Shares ("HUS'es") a resounding victory, clarifying the previously murky issue of whether HUS'es can enjoy rights and privileges that are not available to "regular" shareholders. The Court answered "yes", but in doing so may have opened Pandora's Box.

In *Bellstell 7 Park Avenue, LLC v. The Seven Park Avenue Corporation*, the Appellate Division, First Department held that the industry-standard proprietary lease provision that exempts HUS'es from a co-op's sales and subletting restrictions and fees is valid and enforceable, and does not violate State law. Interestingly (and somewhat contradictorily), the Court noted that the existence of such rights and privileges makes the shares held by HUS'es "de facto, a different class of stock than [the shares held by] an ordinary purchaser". The Court distinguished this case from its 2019 ruling in *Pastena v. 61 W. 62 Owners Corp.*, stating that the *Pastena* decision merely struck down rights and privileges held by shareholders who were original purchasers from a sponsor, and not any rights or privileges held by a HUS. Thus, under *Bellstell*, a HUS is exempt from sales, subletting, alterations and other restrictions and fees (including flip taxes) to the extent that that co-op's proprietary lease so provides. Following *Pastena*, many co-op Boards and managing agents had sought to apply such restrictions and fees to HUS'es. No longer.

While giving welcome clarity on the narrow issue of rights and privileges, however, the Court's decision potentially creates a much larger issue.

By explicitly declaring that unsold shares "are" a second class of shares, the Court implicitly opened the door to claims that a co-op with such rights and privileges for HUS'es violates the requirement of Business Corporation Law §501(c) that all shares of a corporation be equal, and of Internal Revenue Code §216(b)(1)(A) that a co-op can have only one class of shares. Violating either—and especially the Internal Revenue Code provision—could jeopardize a co-op's status as a co-op, and, thus, the tax deductible treatment accorded to shareholders' maintenance payments and co-op loan payments, and the favorable treatment afforded to a gain on apartment resale. By clarifying one area, the Court may have just moved the murkiness elsewhere.

*Aaron Shmulewitz heads the Firm's co-op/condo practice, and can be reached at **ashmulewitz@bbgllp.com**, or 212-867-4466, ext. 390.*

BBG In The News

Founding partner **Sherwin Belkin** was quoted in a January 8 article in *law360.com* criticizing the Emergency Eviction and Foreclosure Prevention Act and its effect on owners: **Read article here**.

Litigation Department head and co-managing partner **Jeffrey L. Goldman** was quoted in a January 21 article in *The Real Deal* decrying a proposed ban on commercial evictions being promoted by Governor Cuomo: **Read article here**, and in a January 28 article in the same publication discussing the increasing frequency of owner suits against commercial tenants for unpaid rent: **Read article here**.

Litigation Department partner **David M. Skaller** was quoted in the Ask Real Estate feature of *The New York Times* Sunday Real Estate section on January 9, regarding alternative options for owners with tenants who are delinquent in rent: **Read article here**, and in the same feature of *The New York Times* Sunday Real Estate section on March 21, discussing a landlord's options against a non-paying tenant: **Read article here**.

Partner **Robert T. Holland** of the Firm's Litigation Department is representing a Riverside Boulevard condominium in a suit seeking to recover unpaid common charges from former NBA star Dikembe Mutombo; the suit was reported in a March 8 article in *Crain's New York*: **Read article here**.

The Firm's lease signing for its new office space at One Grand Central Place was covered in a January 20 column in *The New York Post*: **Read article here**, and in a January 29 article in Real Estate Weekly: **Read article here**.

Co-Op | Condo Corner

BY AARON SHMULEWITZ

Aaron Shmulewitz heads the Firm's co-op/condo practice, consisting of more than 300 co-op and condo Boards throughout the City, as well as sponsors of condominium conversions, and numerous purchasers and sellers of co-op and condo apartments, buildings, residences and other properties. If you would like to discuss any of the cases in this article or other related matter, you can reach Aaron at 212-867-4466, extension 390, or (ashmulewitz@bbgllp.com).

CONDO UNIT OWNER OBLIGATION TO PAY COMMON CHARGES IS ABSOLUTE; UNIT OWNER CANNOT DEDUCT FROM COMMON CHARGES DUE TO ALLEGED DEFECT IN APARTMENT VENT

Board of Managers of The 200 East 65th Street & 210 East 65th Street Condominium v. McCallum
Supreme Court, New York County

COMMENT | The Court granted the Condominium's motion for summary judgment on its action to foreclose on its lien against the apartment. An all-around victory for the Condominium, which was represented by BBG.)

TENANT IN CONDO UNIT CAN SUE UNIT OWNER AND CONDO FOR TOXIC MOLD INJURIES CAUSED BY FLOODING

Desernio v. Ardelean Appellate Division, 2d Dept.

COMMENT | The Court held that the Condominium owed a duty of care to tenants too. The Condominium and the Unit Owner failed to eliminate all material questions of fact.

NON-PURCHASING SENIOR CITIZEN TENANTS IN BUILDING BEING CONVERTED TO CONDO UNDER NON-EVICTION PLAN ARE NOT ENTITLED TO PROTECTION FROM EVICTION

Kessler v. Carnegie Park Associates, L.P.
Appellate Division, 2d Dept.

COMMENT | The tenants' leases expired between the Attorney General acceptance date in 2015 and the offering plan's effective date. (The law was subsequently changed to afford such protection to such non-purchasing tenants in future conversions.)

CO-OP SHAREHOLDER'S FAILURE TO SEEK INJUNCTION PRIOR TO EXPIRATION OF CURE PERIOD BARS ISSUANCE OF INJUNCTION TO STOP CO-OP'S FORECLOSURE SALE OF APARTMENT

Hargraves v. Tyler Towers Owners Corp.
Appellate Division, 2d Dept.

CONDO GARAGE UNIT OWNER CAN OPERATE GARAGE AS A PUBLIC PARKING FACILITY

Condominium Board of Managers of Tribeca Summit v. 415 PR LLC
Appellate Division, 1st Dept.

COMMENT | A 2013 change in the City's zoning law permitted such public parking, and the Department of Buildings indicated that it had no objection.

CO-OP CANNOT FORCE COMMERCIAL TENANT TO VACATE FOR UP TO ONE YEAR TO ENABLE INSTALLATION OF ELEVATOR IN BUILDING, WITHOUT COMPENSATION

12 Wooster Street Tenants Corp. v. 12 Wooster Street Leasing Corp.
Supreme Court, New York County

COMMENT | Gutsy co-op.

CO-OP ENJOINED FROM EVICTING SON OF DECEASED SHAREHOLDER AFTER DECLINING CONSENT TO ESTATE'S TRANSFER TO HIM

Olcott v. 308 Owners Corp. Appellate Division, 1st Dept.

COMMENT | The Court emphasized the proprietary lease's reasonableness standard for estate transfers (which is common in the industry), and intimated that the Board had acted unreasonably in denying the transfer, in light of the son's finances. A similar decision is below.

CONDO CAN HOLD FORMER MANAGING AGENT IN CONTEMPT FOR FAILURE TO TURN OVER DOCUMENTS AS ORDERED PREVIOUSLY BY COURT

The Board of Managers of The Lux Condominium v. Core Management NY LLC Supreme Court, New York County

COMMENT | The managing agent had turned over the required information in a format different from what the Court had ordered, and late.

CONTINUED ON PAGE 13

CONTINUED FROM PAGE 12

CO-OP SHAREHOLDER CANNOT SUE HDFC CO-OP FOR SEEKING TO RENEW REGULATORY AGREEMENT WITH HPD

Scher v. Turin Housing Development Fund Company
Appellate Division, 1st Dept.

COMMENT | The decision analyzed the bases for bring a derivative claim.

COMMERCIAL CONDO UNIT OWNER CANNOT SUE BOARD FOR ITS REFUSAL TO PERMIT RESTAURANT TENANT TO INSTALL EXHAUST SYSTEM

Avenue A Associates LP v. Board of Managers of The Hearth House
Appellate Division, 1st Dept.

COMMENT | Somewhat unusually for commercial units, the Declaration and bylaws gave the Board the right of consent.

CONDO BOARD'S REPRESENTATIVES ARE ENTITLED TO ENTER UNIT OWNER'S APARTMENT TO REPAIR HVAC UNITS THAT SERVICE OTHER APARTMENTS

Board of Managers of Carriage House Condominium v. Healy
Appellate Division, 1st Dept.

HOLDERS OF UNSOLD SHARES IN CO-OP CAN ENJOY RIGHTS AND PRIVILEGES NOT AVAILABLE TO REGULAR SHAREHOLDERS

Bellstell 7 Park Avenue, LLC v. The Seven Park Avenue Corporation
Appellate Division, 1st Dept.

COMMENT | Discussed at greater length elsewhere in this newsletter.

CO-OP SHAREHOLDER BARRED FROM SUING CO-OP FOR WATER LEAK DAMAGES, SINCE SHE ASSERTED THOSE AS COUNTERCLAIMS AND AFFIRMATIVE DEFENSES IN PRIOR EVICTION PROCEEDING BROUGHT BY CO-OP AND SETTLED BY STIPULATION

Fabricius v. 1150 Fifth Avenue Owners Corp.
Supreme Court, New York County

COMMENT | The Court stressed res judicata–the shareholder could have preserved her right to assert those claims, but failed to to do so.

COVID MORATORIUM BARS EJECTMENT ACTION BY CO-OP IN SUPREME COURT

Jacob Cram Cooperative, Inc. v. Ziolkowski
Supreme Court, New York County

COMMENT | The Court emphasized the remedial intent of the moratorium in extending it beyond Civil Court eviction proceedings.

EASEMENT GRANTED IN CONDO DOCUMENTS MAY HAVE BEEN ABANDONED DUE TO NON-USE

Board of Managers of The 190 Meserole Avenue Condominium v. Board of Managers of The 188 Meserole Condominium
Appellate Division, 2d Dept.

COMMENT | The easement was for residents of one condo to access the street through the grounds of the neighboring condo. Questions of fact were held to bar summary judgment.

CO-OP ACTED UNREASONABLY IN REFUSING CONSENT TO TRANSFER FROM ESTATE TO DECEDENT'S DAUGHTER

Kotler v. 979 Corporation Appellate Division, 1st Dept.

COMMENT | The Court held that the Board imposed unreasonable financial standards on the daughter in violation of the proprietary lease's "not to be unreasonably withheld" standard. The daughter was awarded the apartment, and monetary damages, and attorneys fees—and the co-op's flip tax was held inapplicable to the transfer. A bad day for this co-op.

ASSIGNEE OF SUCCESSFUL BIDDER AT PUBLIC AUCTION OF CO-OP APARTMENT CAN SUE THE CO-OP FOR REJECTING HIS PURCHASE APPLICATION

Louzon v. Gentry Apts., Inc. Appellate Division, 2d Dept.

COMMENT | The co-op was found to have based its rejection on conditions not previously included in the terms of sale.

CONTINUED ON PAGE 14

CONTINUED FROM PAGE 13

CO-OP SHAREHOLDER CANNOT SUE CO-OP AGAIN OVER CLAIM THAT COULD HAVE BEEN BROUGHT IN PRIOR ACTION, SETTLED IN 2011

Greenaway v. Clifton & Classon Apartment Corporation
Appellate Division, 2d Dept.

CONDO UNIT OWNERS CANNOT SUE BOARD MEMBERS FOR HOLDING VOTE TO AMEND BYLAWS TO ELIMINATE DISCREPANCIES IN TWO DIFFERENT VERSIONS

72 Poplar Townhouse LLC v. Board of Managers of The 72 Poplar Street Condominium
Supreme Court, Kings County

COMMENT | The Court based its holding on the business judgment rule, and found no evidence of self-dealing or other wrongdoing.

CO-OP SHAREHOLDER CANNOT SUE CO-OP FOR ERECTION OF SIDEWALK SHED

Kirschner v. 233 West 99th Street, Inc.
Supreme Court, New York County

COMMENT | The Court held that the sidewalk shed was required by law in order to protect the public—the co-op had no choice.

CONDO DOCUMENTS BAR COMMERCIAL UNIT OWNER FROM INSTALLING SIGN ON BUILDING EXTERIOR

The Board of Managers of The 80th at Madison Condominium v. 1055 Madison Avenue Owners LLC
Supreme Court, New York County

COMMENT | But the prior commercial tenant's installation of sign on building exterior raised material questions of fact, which bar summary judgment to the Condominium.

Belkin • Burden • Goldman, LLP
270 Madison Avenue, New York, NY 10016

Belkin · Burden · Goldman, LLP
ATTORNEYS AT LAW

www.bbgllp.com

270 Madison Avenue, New York, NY 10016 | Tel: 212.867.4466 | Fax: 212.297.1859