GANFER SHORE LEEDS & ZAUDERER LLP

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COURT HOLDS THAT WHEN AN LLC OWNS UNSOLD SHARES, THEY RETAIN THAT STATUS DESPITE OCCUPANCY BY A MEMBER OF THE LLC'S OWNER'S FAMILY

In past issues of this *Client Advisory*, we have reported on disputes concerning whether a cooperative sponsor or its successor remains a "holder of unsold shares," whose units are exempt from requirements such as board approval of purchasers and payment of flip taxes or sublet fees. The standard form of proprietary lease provides that the status of a holder of unsold shares will be lost if "the holder of such shares (or a member of his family) becomes a bona fide occupant of the apartment." A recent case raised the issue of how to interpret this provision when, as is often the case, the sponsor or its successor is an entity, such as a limited liability company (LLC) rather than an individual. **Bellstell 7 Park Avenue, LLC v. Seven Park Avenue Corporation, 2019 N.Y. Misc. LEXIS 6871, 2019 N.Y. Slip Op. 29402 (Sup. Ct. N.Y. Co. Dec. 23, 2019).**

In this case, the successor to the sponsor was an LLC named Bellstell. Through a series of intermediate entities, Bellstell is ultimately owned by one individual. In 2015, Bellstell sublet one of its apartments to that individual's daughter. The Cooperative notified Bellstell that because the apartment had been occupied by a family member of the owner, the shares corresponding to it were no longer "unsold shares." Bellstell disagreed and filed a declaratory judgment action asking the court to decide. Bellstell contended that because it is not an individual but an entity, the concept of "members of his family" did not apply and that any attempt to define an LLC's "family members" would create difficulties. The Cooperative responded that the apartment was being occupied by "a principal ... and member of the family which owns and controls Bellstell," so the occupant should be considered a family member in determining "holder of unsold shares" status.

The court agreed with Bellstell, stating that it could see no principled or practical means of defining when an individual's relationship with an LLC is sufficient for him or her to be deemed a "family member" of the LLC. (The court also observed in passing that the language of the proprietary lease "read literally for all it is worth, might indicate that artificial persons like limited-liability companies cannot hold unsold shares in the first place, precisely because they do not have family," but did not rule on this issue.) This case was decided by a single trial court, and it remains to be seen whether it will be followed by other courts. The decision has been appealed, and we will report in this *Client Advisory* when the appeal is decided.

GUIDELINES FOR DEALING WITH THE CORONAVIRUS THREAT

All boards, landlords, and employers need to be thinking about issues relating to the ongoing spread of the novel coronavirus. Residents and employees are concerned about the implications of this new virus and how it may affect their lives. The latest guidance on dealing with these issues can be found on the websites of the Centers for Disease Control (https://www.cdc.gov/coronavirus/2019-ncov/summary.html), New York State Health Department (https://www.health.ny.gov/diseases/communicable/coronavirus/), or New York City Department of Health (https://www1.nyc.gov/site/doh/health/health-topics/coronavirus.page). There are also posters available reminding everyone to use good health habits such as regular hand-washing.

One point that medical experts and the authorities are stressing is that people who may be suffering from coronavirus or any other communicable disease (including colds or the flu), or who are experiencing any

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symptoms, should stay home and not go to work. Employers should emphasize: If you are sick, you are expected to stay home, out of consideration for your colleagues and their families, and the community. This is a good time for employers to review their sick-leave policies and ensure that they don't send the opposite message. Also, in the contexts of cooperatives, condominiums, and rental buildings, boards and owners may wish to begin considering how they would handle the potential effects on their buildings of residents' being confined at home for long periods if there is a serious outbreak, even though everyone hopes this will never become necessary. Other organizations may also wish to plan ahead for the possibility of having to temporarily close their facilities during a disease outbreak and having employees work from home or curtail travel plans.

WARRANTY OF HABITABILITY HELD BREACHED BY CONSTRUCTION WORK

Every residential lease in New York incorporates a warranty of habitability. In **West 30th Realty LLC v. Castaldo, 2020 N.Y.L.J. LEXIS 306, Index No. 58883/2014 (Civil Court N.Y. Co. Jan. 23, 2020)**, tenants contended that this warranty of habitability was breached by conditions including scaffolding outside their windows, which blocked light from the premises, made it impossible to use the air conditioner, and deprived the tenants of privacy when contractors were present outside their windows. In addition, various tenants testified that for years, construction activity caused "horrendously loud" noise as well as extensive dust contamination and vibration. The court stated that "[w]hile [the landlord] argues that construction is a reality of New York City living, such a reality does not gainsay the negative effect that construction can have on the habitability of an apartment." Although the courts had allowed 25% rent abatements for noise, vibrations, and dust caused by daytime construction activity, in this case the landlord had misrepresented to the Department of Buildings that the building was unoccupied, thus avoiding the requirement to submit a tenant protection plan. The court concluded that this "aggravating factor" warranted an increased rent abatement of 40%.

BROAD CHALLENGE TO NEW YORK'S PROPERTY TAX SYSTEM IS DISMISSED

Property owners in New York City know that the system for calculating real property assessments and taxes is extremely complicated depending on, among other things, the type of property involved. A group of owners and renters of real property filed a widely publicized lawsuit against New York State and City authorities, contending that the system is so discriminatory and unfair as to be unconstitutional. Among other things, the plaintiffs sought to invalidate certain provisions of the tax laws and current practices that benefit residential cooperatives and condominiums. However, the Appellate Division dismissed the case, based on the broad discretion that the State Legislature enjoys on the subject of taxation. **Tax Equity Now NY LLC v. City of New York, 2020 N.Y. App. LEXIS 1465, 2020 N.Y. Slip Op. 1401 (1st Dep't Feb. 27, 2020)**.

EMPLOYERS SHOULD BEGIN USING NEW FEDERAL I-9 FORMS

U.S. Citizenship and Immigration Services has published a new version of Form I-9, the Employment Eligibility Verification Form that must be completed by newly hired employees. This new form, which is available on the USCIS website and bears the notation "Rev 10/21/2019," reflects only minor changes from the prior version. Employers should begin using it immediately, although using the prior version is also permissible through April 30, 2020. The change does not require any action regarding existing employees.

2019 LANDLORD/TENANT LEGISLATION CONTINUES TO AFFECT COOPERATIVES

We have reported in prior issues of this *Client Advisory* on several ways in which the Housing Security and Tenant Protection Act, enacted by the New York State Legislature in 2019, is affecting cooperatives. Justin R. Bonanno, a partner at Ganfer Shore Leeds & Zauderer LLP, recently authored an article on this subject in the Winter 2020 issue of the *New York Real Property Law Journal*, a publication of the Real Property Section of the New York State Bar Association. A copy of this article is enclosed.

The Adverse Impact of the Statewide Housing Security and Tenant Protection Act of 2019 on Co-ops

By Justin R. Bonanno

A major overhaul of statewide legislation governing landlords' and tenants' rights, the Statewide Housing Security and Tenant Protection Act of 2019 (HSTPA), was signed into law by Governor Cuomo on June 14, 2019. The HSTPA, most of which took effect immediately, made changes and additions to New York's Real Property Law (RPL), Real Property Actions and Proceedings Law (RPAPL), and other laws that significantly affect all aspects of New York's housing industry. Because cooperative housing corporations ("co-ops") are lessors under their proprietary leases and are considered landlords for most purposes, and because the HSTPA does not expressly exclude them, the HSTPA applies to co-ops.[1] Whether the HSTPA was *intended* to apply to co-ops is up for debate.

The relationship between a tenant-shareholder and a co-op differs from a traditional landlord-tenant relationship because co-ops are non-profit corporations that are owned by, and operated for the benefit of, their tenant-shareholders, whereas rental buildings are owned by traditional landlords who are generally profit-motivated.[2] Unlike rental tenants, tenant-shareholders have, through the election process, a say (and a legitimate interest) in how their buildings are operated, including, among other things, what fees and expenses are charged, what rules are set and followed by the community, and what co-op procedures are implemented. Certain sections of the HSTPA could significantly restrict co-ops' freedom of action in these areas.

Some real estate industry groups have filed a federal litigation challenging provisions of the HSTPA. A lobbying effort has also been commenced seeking to convince the Legislature to amend the law so that it would not apply to co-ops. Those efforts already appear to be bearing some fruit as Senator John C. Liu introduced a bill (S6770) on October 9, 2019, which seeks to exclude co-ops from certain provisions of the HSTPA.[3] The Legislature may consider this new proposal in its current 2020 session but, of course, there is no guarantee the bill will be passed and enacted into law. Thus, for now, the HSTPA will continue to apply to co-ops. Following is a discussion on how this could have perhaps unintended adverse consequences on co-ops and their tenant-shareholders.

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Co-op Boards Are More Likely to Outright Reject Prospective Purchasers with Credit Issues

First, the HSTPA amended General Obligations Law (GOL) § 7-108 to limit any required security "deposit or advance" payable by a tenant to the amount of one month's rent. This HSTPA provision applies to "any lease or rental agreement or renewal of a lease or rental agreement" entered into on or after July 14, 2019, and thus does not affect deposits related to leases or rental agreements already in place as of that date. The HSTPA imposes potentially serious penalties for a violation of this provision, as it provides that "any person" who violates it "shall be liable for actual damages," and in addition, that "a person found to have willfully violated this subdivision shall be liable for punitive damages of up to twice the amount of the deposit or advance."

This provision could be interpreted to limit the amount that potential tenant-shareholders are required to deposit under maintenance escrow agreements. Maintenance escrows are typically used to permit an otherwise financially questionable applicant to acquire the stock and proprietary lease appurtenant to an apart-

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ment by depositing (as security) several months' (or more) worth of maintenance into escrow, which can later be drawn upon by the co-op in the event of a monetary default. Co-op boards will likely find that an escrow account holding just one month's worth of maintenance does not provide enough security to justify approving such an application. While boards could consider some alternatives to a maintenance escrow account, such as requiring a guarantor, if the potential tenant-shareholder does not have an acceptable guarantor, this change in the law could result in boards rejecting these types of purchasers. This would make less housing available for prospective purchasers with limited or poor credit history, which appears to be the antithesis of the purpose of the HSTPA.

In addition, while the HSTPA, on its face, does not appear to address security deposits required by co-ops under alteration agreements, it could, based on a very conservative reading of the statute, also be interpreted to limit the amount of alteration deposits to one month's rent as well. Co-op alteration agreements often contain provisions that classify the fees and charges tenant-shareholders are required to pay as "additional rent" under their proprietary leases, which can then be deducted from the alteration security deposits. These "cross-default" provisions relating alteration agreements to proprietary leases might be enough to bring alteration security deposits within the scope of this amendment.

If the courts interpret this provision to apply to co-op alteration agreements, this will present a potentially serious problem for co-op boards. Alteration agreements typically require a substantial security deposit to provide protection against any loss, cost or expense to the co-op arising from or relating to tenant-shareholders' renovations, such as damage to the building, the fees of any construction professionals retained by the co-op to review plans and the progress of the work, and the co-op's attorneys' fees. Limiting alteration deposits to "one month's rent" will not provide adequate protection to the co-op during tenant-shareholder renovations.

Unless the Legislature clarifies whether this amendment applies to co-ops, this will put boards in an untenable position. If boards decide that GOL § 7-108 does not apply to alteration deposits, they run a risk that the statute will later be interpreted to apply to such deposits, potentially subjecting them to the serious penalties set forth in the statute. If, on the other hand, boards decide not to take that risk, this will leave them looking for other ways to find adequate protection, a feat that could be difficult to achieve.

Board Due Diligence Concerning Prospective Purchasers Will Be Significantly Hindered

The HSTPA also adds a new § 227-f to the RPL which prohibits the "landlord of a residential premises" from refusing to offer a lease to a potential tenant because "the potential tenant was involved in a past or pending landlord-tenant action or summary proceeding." In addition, this section of the HSTPA prohibits landlords from relying on tenant screening databases in deciding whether to offer a lease. The new law imposes a "rebuttable presumption" that this section has been violated if information about an applicant was requested from a tenant screening bureau or court records were inspected and the landlord subsequently refuses to rent or offer a lease to the applicant.

This provision effectively prohibits co-ops from requesting information about, considering, or relying on a prospective purchaser's history of litigation with prior landlords in rejecting a purchase application. For co-op boards, this change in the law is a serious impediment to their due diligence process. It has long been the law in New York that a co-op can reject a prospective purchaser for any reason or for no reason at all, so long as the rejection does not violate an anti-discrimination statute. As the Court of Appeals stated as long ago as 1959, "there is no reason why the owners of [a] co-operative apartment house [cannot] decide for themselves with whom they wish to share their elevators, their common halls and facilities, their stockholders' meetings, their management problems and responsibilities and their homes."[4] An applicant's involvement in prior landlord-tenant litigation, in which the applicant may have taken unreasonable positions or in which the court papers may reflect misconduct by the applicant in his or her prior home, is a critical piece of information that boards typically consider to make an informed decision about potential new tenant-shareholders. A litigious shareholder could cost the co-op large sums of money, while a shareholder with a history of engaging in improper behavior while living at other residences could make life less pleasant or more difficult for the other residents of the building.

Increased Litigation in the State's Already Overburdened Court System

Another new section of the law (RPAPL § 702) defines what types of "rent" can be recovered in a summary proceeding in landlord-tenant court (also known in New York City as Housing Court, as opposed to a separate action in county civil court or state Supreme Court). The rent recoverable in summary proceedings now excludes any "fees, charges or penalties," even if they are specifically authorized by the lease and are classified in the lease as "additional rent." Unpaid co-op charges such as late fees, utilities, repair costs and possibly even special assessments now cannot be sought in a summary proceeding commenced on or after June 14,

2019, and can only be sought in a separate civil court or Supreme Court action.

This will likely result in an increase in litigation in this state's already overburdened court system. In the process, this section of the HSTPA will substantially increase the attorneys' fees and disbursements co-ops must incur in order to collect unpaid fees, charges or penalties, or cause co-ops to decide that pursuing separate litigation is not cost-effective and temporarily forgo collection efforts. Ultimately, it will fall on the other tenant-shareholders to cover the additional costs or shortfalls due to another tenant-shareholder's failure to pay all of his or her "fees, charges or penalties."

Delinquent Tenant-Shareholders Can Now Use Co-ops to "Finance" Their Cash-Flow Needs

Similarly, the HSTPA added § 238-a to the RPL, which precludes a "landlord, lessor, sublessor or grantor" from, among other things, charging late fees that are in excess of $50, or 5% of the monthly rent, whichever is less. This provision will prevent co-ops from charging their customary late fees and interest, which typically exceed $50 per month. The purpose of charging these fees is to encourage tenant-shareholders to pay their maintenance on time. Co-op tenant-shareholders who chronically pay their maintenance late can now take advantage of the new law, and use the co-op to "finance" their other cash flow needs. It will fall on the other tenant-shareholders to cover the deficits created by those who choose to pay, for example, their higher interest rate credit cards first before paying their maintenance.

Managing Agents Could Decide to Cease Processing Purchase Applications Unless the Co-op Agrees to Pay Their Purchase Application Processing Fees

Finally, the new RPL § 238-a also prohibits landlords from charging a fee for processing, reviewing, or accepting "an application" to rent property, except a fee for a background or credit check, which cannot exceed $20 or the actual cost of the background or credit check, whichever is less. A copy of the background or credit check and the receipt or invoice from the entity that conducted the check must be provided to the applicant before the fee can be collected. Moreover, if an applicant provides his or her own background or credit check that was conducted within the past 30 days, then no fee can be charged for the landlord to conduct a check.

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This provision may be interpreted to preclude co-ops from imposing application fees of more than a nominal amount (which is typically required to compensate managing agents for reviewing and processing purchase applications) or even passing on the actual cost of background or credit checks to potential tenant-shareholders seeking to obtain a proprietary lease. Most co-op application fees run into the hundreds of dollars. Most often, application fees are charged by and paid to the co-op's managing agent rather than the co-op directly. The new law does not expressly prohibit an *agent* of any "landlord, lessor, sublessor or grantor" from charging an application fee that exceeds $20. This raises the question whether managing agents are truly exempt or whether they are merely performing a ministerial task on behalf of the co-op and are also barred from charging more than $20. If the courts determine that the HSTPA does prohibit managing agents from charging their standard application processing fees, managing agents could decide to cease processing purchase applications unless the co-op agrees to pay the managing agent's full fee. This will force co-op boards in the precarious position of either having the entire tenant-shareholder community pay the fee or (more likely) pass it on to sellers.

While, as discussed above, the Legislature has not weighed in on whether the HSTPA was intended to apply to co-ops, in September 2019 the New York Department of State provided a "glimmer of hope" when it issued a "Guidance for Real Estate Professionals Concerning the Statewide Housing Security & Tenant Protection Act of 2019" that addresses this provision.[5] According to the Department of State, the $20 limit does not apply (i) "[w]hen a property is being sold including within a COOP or Condo," and (ii) to "[a]pplication fees imposed by [a] COOP/Condo board (i.e., fees charged by persons other than the unit owner)." Unfortunately, the "guidance" offered by the Department of State is not authoritative or legally binding on the courts. Thus, for now, the limitation on application fees still appears to apply to co-ops.

Conclusion

It is unclear whether the HSTPA was intended to apply to co-ops. What is clear is that the HSTPA has several provisions that, if applied to co-ops, could have significant adverse consequences for co-op management and operations. The examples set forth above are just a few. While there are efforts underway to amend the act to exclude co-ops, the success of those efforts is uncertain and, even if they are ultimately successful, it will take time to play out. In the meantime, co-op boards would be wise to speak to counsel to look for ways to insure compliance with these new laws, while mitigating any negative impact.

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Endnotes

1. *See, e.g., Lincoln Guild Housing Corp. v. Stuckelman*, No. LT058129/91, 1992 WL 12667689 (N.Y. Civ.Ct. 1992) (finding "[w]here the legislature wishes to exclude proprietary leases from coverage by a section of the Real Property Law, it specifically carves out the exception, such as RPL 226-b(3)"); *Southridge Coop. Section No. 3, Inc. v. Menendez*, 141 Misc. 2d 823, 827, 535 N.Y.S.2d 299, 302 (Civ. Ct. Queens County 1988) (stating "the courts have concluded that the language, 'lease or rental agreement for residential premises' is not intended by the Legislature to except proprietary leases from Real Property 235-b").

2. *See 40 W. 67th St. Corp. v. Pullman*, 100 N.Y.2d 147, 155, 790 N.E.2d 1174, 1180, 760 N.Y.S.2d 745, 751 (2003) (finding "the relationships among shareholders in cooperatives are sufficiently distinct from traditional landlord-tenant relationships"); *see also Suarez v. Rivercross Tenants' Corp.*, 107 Misc. 2d 135, 137, 438 N.Y.S.2d 164, 166 (App. Term, 1st Dep't 1981) (quoting *Matter of State Tax Commn. v. Shor*, 43 N.Y.2d 151, 154, 371 N.E.2d 523, 400 N.Y.S.2d 805 (1977)) (stating "the relationship created [between co-ops and tenant-shareholders] has also been called *sui generis*, i.e., peculiar, unique, different . . . As Chief Judge Breitel, writing for a unanimous Court of Appeals, observed (p 156): 'One has, therefore, a mixed concept and terminology, superficially resembling the traditional rental apartment lease, except, for example, that the lessee pays monthly maintenance charges and is subject to assessments instead of rent. For some purposes it is a lease; for others it is a compact between co-operative corporation and co-operative tenant'").

3. Amendment to Housing Stability and Tenant Protection Act, S. 6770, 116th Cong., General Obligations Law (as introduced by S. Liu on the Judiciary, October 9, 2019).

4. *Weisner v. 791 Park Ave. Corp.*, 6 N.Y.2d 426, 434, 160 N.E.2d 720, 190 N.Y.S.2d 70 (1959).

5. *Guidance for Real Estate Professionals Concerning the Statewide Housing Security & Tenant Protection Act of 2019*, https://www.dos.ny.gov/licensing/pdfs/DOS-Guidance-Tenant-Protection-Act-9.13.19.pdf (October 23, 2019).