Loft Law

Departments Split Over Stabilization Status

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In its Oct. 21, 2008 decision in *Caldwell v. American Package Co. Inc.*, NYLJ, Oct. 29, 2008, at 31, col. 1, the Appellate Division, Second Department, sharply diverged from the Appellate Division, First Department, as to when a commercial loft that is residentially occupied can become subject to rent stabilization, and whether tenants living in such lofts, prior to legalization, must pay rent.

A unanimous Second Department panel found that a landlord that allowed tenants to reside in a commercial property may eject them for violating their lease and failing to pay rent, but that it may not recover unpaid back rent.

The decision to preclude back rent marks a split with the First Department, which has ruled that a tenant who knows that a tenancy is illegal may not enjoy the benefits of occupancy then shirk the duty to pay.

The split between the departments arises from their conflicting interpretations of the Court of Appeals' decision in *Wolinsky v. Kee Yip Realty Co.*, 2 NY3d 487, 779 N.Y.S.2d 812 (2004).

'Wolinsky'

The landlord in *Wolinsky* owned a seven-story commercial building in Manhattan. In 1997, the landlord entered into commercial leases with various tenants for loft space in the building. The tenants then renovated their spaces for residential use. As their purportedly commercial leases began to expire, the tenants sought a declaration in Supreme Court that their lofts had become subject to the Rent Stabilization Law and Code by virtue of the Emergency Tenant Protection Act ("ETPA") (L. 1974, ch. 576, §4). Because the ETPA did not expressly prohibit municipalities from extending stabilization protection to illegal loft units, the tenants argued they were covered.

The tenants' argument was animated by the fact that they could not otherwise qualify for protection under the New York City Loft Law (Multiple Dwelling Law §280 et seq.). That law only applies to a loft building which "on December first, nineteen hundred eighty-one was occupied for residential purposes since April first, nineteen hundred eighty as the residence or home of any three or more families living independently of one another." MDL §281(1)(iii). The loft units in *Wolinsky* did not so qualify.

The Court of Appeals, affirming the First Department and Supreme Court, found for the landlord, writing:

> Reading the ETPA and Loft Law together, we agree with the courts below that tenants' illegal conversions do not fall under the ambit of the ETPA. As reflected in the legislative history and intent of the Loft Law, the fixed eligibility period was designed to address the public safety and municipal zoning emergency caused by the expansion of illegal conversions at that time. The statute was not intended to foster future illegal conversions or undermine legitimate zoning prerogatives. If the prior-enacted ETPA already protected illegal residential conversions of manufacturing space, significant portions of the Loft Law would have been unnecessary. Thus, although such illegal conversions are not expressly exempted from ETPA coverage, it is evident that the Legislature did not view the ETPA as safeguarding the interests of the 'loft pioneers'" (internal citations omitted).[1]

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The Court of Appeals added that neither the city nor the legislature had enacted legislation that would "confer Loft Law protections on later conversions," and that such steps "could make residential loft units like tenants' legal or capable of being legalized...."[2]

First Department Stance

Focusing on the Court of Appeals' statement quoted immediately above, the First Department has held that a loft tenant otherwise not covered by the Loft Law can become rent stabilized where legalization can be effectuated. In *Dwayne Thomas LLC v. Wallin*, 35 AD3d 232, 233, 826 N.Y.S. 221 (1st Dept. 2006), the First Department affirmed Supreme Court's declaration that the tenant was rent stabilized, holding:

> Although tenant commenced occupancy in 1991, after the initial Loft Law window period had closed without the subject unit having been registered with the Loft Board, the applicable Zoning Resolution (Tribeca Mixed Use District) permits residential use of 'loft dwellings,' which the subject building admittedly is, and does not expressly require that such dwellings be covered by the Loft Law. In fact, a temporary residential certificate of occupancy covering the unit was obtained by landlord in 2002, in accordance with the parties' 2001 agreement. It therefore appears that the unit is capable of being legalized, and may therefore be subject to rent stabilization (internal citations omitted).

The First Department ruled to the same effect in *142 Fulton LLC v. Hegarty*, 41 AD3d 286, 839 N.Y.S.2d 45 (1st Dept. 2007). Thereafter, various lower courts in the First Department (and some in the Second Department) ruled that illegal lofts may become rent stabilized where the unit is capable of legalization, and the owner knew of or acquiesced in the tenant's conversion to residential use. See, e.g., *80 Varick Street Group L.P. v. Nichols*, 18 Misc.3d 1132 (A) (N.Y. City Civ. Ct. 2008).

Second Department

In *Gloveman Realty Corp. v. Jefferys*, 18 AD 3d 812, 795 N.Y.S.2d 462 (2d Dept. 2005), the Second Department affirmed a finding that the tenants were not rent stabilized, even though Supreme Court had noted that the landlord knew of and acquiesced to the tenants' conversion of the space for use as a residence. In *315 Berry St. Corp. v. Hanson Fine Arts*, 39 AD3d 656, 657, 835 N.Y.S.2d 261 (2d Dept. 2007), the Second Department affirmed the tenant's status as a rent stabilized tenant, writing that it was "undisputed that the petitioner...knew of and acquiesced in the unlawful conversion," and that the landlord "sought legal authorization to convert the premises to such use." The Court concluded that "[u]nder these circumstances, the unit at issue was properly determined to be subject to the rent regulations of the Emergency Tenant Protection Act of 1974." Id.

'Caldwell'

In *Caldwell*, the tenants lived in commercial loft space in a building for which there was no residential certificate of occupancy. The tenants commenced an action seeking a declaration that they were subject to rent stabilization by virtue of the ETPA. Supreme Court, Kings County (Lewis, J.) ruled against the tenants, who thereafter appealed. The Second Department unanimously affirmed in an opinion authored by Justice Robert A. Spolzino. Justices Howard Miller, Mark C. Dillon and William E. McCarthy joined in the opinion.

After analyzing the differences between the First Department and Second Department as to when an illegal loft may become rent stabilized, the Second Department declared that under its reading of *Wolinsky*, there was only one possible route to stabilization: the narrow route the Court had laid out in *315 Berry St.*:

> *315 Berry St.* presents the one situation in which, consistent with *Wolinsky*, ETPA protection can be recognized for illegally converted commercial premises. There, the owner acquiesced in the unlawful conversion, undertaken at the expense of the occupants, the premises were otherwise eligible for residential use by reason of the applicable zoning, and the owner, during the pendency of the proceeding in which the tenant sought ETPA protection, actually sought to legalize the residential use. In those circumstances, both parties, while aware that a claim of ETPA protection had been asserted, pursued a course leading to that end. We simply endorsed the status that each of the parties had sought. The broader exception the tenants seek here, which would recognize ETPA protection

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whenever a building owner has acquiesced in an illegal conversion that is merely 'capable of being legalized,' would be inconsistent with *Wolinsky*'s declaration that ETPA protection is inapplicable to illegal conversions" (internal citations omitted).

The Second Department then addressed the issue of whether the tenants—who clearly knew that their space was not legal—were estopped from raising Multiple Dwelling Law §302, which prohibits the owner of a multiple dwelling for which there is no valid certificate of occupancy allowing residential use from collecting rent. The Second Department noted that the First Department had ruled that a tenant would indeed be estopped where the tenant was aware his or her occupancy was illegal. Second Department disagreed, holding:

> The public policy intended to be served by Multiple Dwelling Law §302 was explicitly identified by the Legislature when it declared in adopting the provision that 'the establishment and maintenance of proper housing standards requiring sufficient light, air, sanitation and protection from fire hazards are essential to the public welfare.' The Legislature further decided to cast upon the owner the obligation to ensure compliance by expressly depriving the owner of any entitlement to rent or other remuneration in the absence of a certificate of occupancy. Short of a situation... where the tenant actually interfered with the owner's attempt to legalize the premises, it would be inconsistent with the Legislature's command to shift this burden by estopping the tenant from relying on the statute as a defense. The Supreme Court erred, therefore, in awarding the owner the value of the use and occupancy of the premises pendent lite (internal citation omitted).

It remains to be seen as to whether either party will seek leave to appeal, or whether the Court of Appeals will grant leave.

1. 2 NY 3d at 493.
2. Id.