RENT REGULATION

Courts Differ on Rights Of Tenants in Illegal Lofts

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A recent decision by the Appellate Division, Second Department, in *Caldwell v. American Package Co. Inc.*[1] addressed issues concerning the rights of tenants in commercial premises illegally converted to residential use, and highlighted a divergence between the Second Department and the First Department on two key issues. One issue is under what circumstances the Emergency Tenant Protection Act of 1974[2] ("ETPA"), and the protections of rent stabilization, might be applicable to such premises. The second issue is the scope of equitable estoppel against a tenant in such premises asserting a defense for non-payment of rent based on Multiple Dwelling Law §302, which bars the owner of a multiple dwelling for which there is no valid certificate of occupancy for residential use from recovering rent for such premises. The Appellate Division decision was written by Justice Robert A. Spolzino, with all the other judges on the panel, i.e., Justice Howard Miller, Justice Mark C. Dillon and Justice William E. McCarthy, concurring. We discuss here the reasoning of the Second Department in *Caldwell* and the nature of its disagreement with the First Department.

In *Caldwell*, the plaintiffs resided, pursuant to a commercial lease, in a commercial building for which there was no residential certificate of occupancy. The defendant was the owner of the building. The lease provided that the premises would be used for "computer services and design studio provided such use is in accordance with the certificate of occupancy for the building, if any, and for no other purpose," and that the tenant "shall make no changes in or to the demised premises of any nature without Owner's prior written consent." The lease also provided that the tenant "will not at any time use or occupy the demised premises in violation of the certificate of occupancy issued for the building...."

The owner served the tenants with a notice to cure, asserting that the tenants had violated the lease by, among other things, altering the unit to permit residential use, so using it and not paying rent. In response, the tenants commenced the Supreme Court action, seeking a judgment that their tenancy is subject to the ETPA and that, as such, the owner is required to provide them with a renewal lease and to register the building as a multiple dwelling.

The tenants also sought, inter alia, an injunction prohibiting the owner from terminating their tenancy or demanding rent except in accordance with the ETPA and a declaration that the owner is prohibited from collecting rent from the tenants so long as the certificate of occupancy for the premises is not for residential use. The owner counterclaimed for a judgment declaring that the tenancy is not subject to rent regulation and enjoining the tenants from altering the unit, continuing to reside in it or sublet it and directing the tenants to restore the unit to its prior condition. The owner also counterclaimed for a money judgment for the unpaid rent or, alternatively, for ejectment.

The tenants moved for a *Yellowstone* injunction permitting them a reasonable opportunity to cure any alleged default and prohibiting the owner from taking any action to evict them during the pendency of the litigation. In response, as relevant here, the owner cross-moved for, among other things, summary judgment declaring that the apartment is not subject to the ETPA and that it could collect the value of use and occupancy.

The Supreme Court, in effect, granted that branch of the owner's cross-motion which was for summary judgment declaring that the tenants' ETPA claims were without merit. The Supreme Court denied the owner's cross-motion for ejectment but granted that branch of the owner's separate motion which was, in effect, for summary judgment on its counterclaim to recover the value of use and occupancy prospectively, pending resolution of the matter. As relevant to the issues discussed in this article, the Appellate Division opinion and order upheld the Supreme Court's determination that the tenants were not entitled to the protections of the ETPA, but modified the Supreme Court's order which had awarded the owner prospective use and occupancy so as to deny entirely the owner's claim for use and occupancy.

The Appellate Division initially noted that New York City appears to be in a second round of conversions of commercial premises to residential use, with the venue now being Brooklyn rather than Manhattan. It pointed out that the first round of conversions had resulted in the Legislature's passage of the Loft Law,[3] which it described as having "permitted the conversion of residentially-occupied commercial and industrial buildings to lawful residential use under certain conditions and established a Loft Board to adjudicate, at least in the first instance, disputes arising under the law." That statute, the court continued, applied, however, only to units that were occupied for residential purposes on April 1, 1980. The unit at issue in *Caldwell* was not so occupied at that time. Accordingly, the Loft Law was not applicable and the tenants, therefore, sought protection for their tenancies under the ETPA.

The Appellate Division began its analysis of the issue of the applicability of the ETPA by citing *Wolinsky v. Kee Yip Realty Corp.*,[4] where the Court of Appeals, in 2004, held that "illegal conversions do not fall under the ambit of the ETPA." The Appellate Division continued:

> Despite the seeming lack of ambiguity in this holding [in *Wolinsky*], however, courts have since struggled to determine whether *Wolinsky's* rejection of ETPA protection for these conversions is absolute.[5]

The court acknowledged that courts in the First Department "have repeatedly held that rent stabilization under ETPA may apply where the unit is capable of legalization and the owner knew of or acquiesced in a tenant's conversion to residential use." It specifically cited two Appellate Division, First Department decisions, *Duane Thomas LLC v. Wallin*[6] and *142 Fulton LLC v. Hegarty*[7] as having enunciated that position.[8]

In *Duane Thomas*, the First Department affirmed the trial court's denial of a motion and cross-motion for summary judgment in a declaratory judgment by a landlord seeking a declaration that tenants who had commenced occupancy of a loft dwelling after the Loft Law window period had closed without the subject unit having been registered with the Loft Board were not rent stabilized tenants. The court stated that it "appears that the unit is capable of being legalized, and may therefore be subject to rent stabilization." As indicia that the unit might be capable of being legalized, the court pointed to the fact that the applicable zoning resolution permitted residential use for loft dwellings and the

fact that a temporary residential certificate of occupancy covering the unit had been obtained by the landlord years before. In *142 Fulton*, the First Department, citing *Duane Thomas*, similarly stated that "[the trial] court properly found that the lofts may possibly be legalized and accordingly that they may be subject to rent stabilization."

In *Caldwell*, the Second Department stated that it had twice addressed—in the cases of *Gloveman Realty Corp. v. Jefferys*[9] and in *315 Berry Street Corp. v. Hanson Fine Arts*[10]—the issue of whether the rejection by the Court of Appeals in *Wolinsky* of ETPA protection for illegal conversions is absolute. It described the holding in *Gloveman*, a 2005 decision, as follows:

> In *Gloveman Realty Corp. v. Jefferys* [citation omitted], we held, on the authority of *Wolinsky* and without further elaboration, that the defendants' tenancies in the illegally converted lofts at issue were not subject to ETPA. We did so despite the fact that the owner had knowledge of and acquiesced in the tenants' conversion of the space for residential use, and the applicable zoning law did not prohibit residential use.[11]

In its 2007 decision in *315 Berry Street*, the Second Department held that ETPA protection was applicable to a unit illegally converted from commercial to residential use where it was "undisputed that the [owner]...knew of and acquiesced in the unlawful conversion, ...that the applicable zoning generally permits residential use, and that the [owner] sought legal authorization to convert the premises to such [residential] use during the pendency of this proceeding."

In *Caldwell*, the Second Department distinguished *315 Berry Street* from *Gloveman* on the grounds that in the former case, unlike the latter, the owner had taken affirmative steps during the pendency of the proceeding to lawfully convert the premises to residential use. The *Caldwell* court described *Gloveman* as a situation where both the tenants and the owner, "while aware that a claim of ETPA protection had been asserted [by the tenants], pursued a course leading to that end," and the Appellate Division "simply endorsed the status that each of the parties had sought."

The *Caldwell* court characterized the exception recognized in *315 Berry Street* to the *Wolinsky* rule that illegal conversions do not fall within the ambit of the ETPA as being "an extremely limited one, applying only to the particular circumstances described there in [*315 Berry*]." It continued:

> The broader exception the tenants seek here [in *Caldwell*], which would recognize ETPA protection 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.[12]

Accordingly, the *Caldwell* court held that the rule established in *Wolinsky*, and followed by the Second Department in *Gloveman*, "requires that the tenants' request for a declaration that their tenancy is protected by ETPA be resolved against them" and upheld the Supreme Court's determination that the tenants were not entitled to the protections of ETPA.

The second broad issue discussed in *Caldwell*, which also pointed to a divergence between the First and Second Departments, relates to the scope of equitable estoppel against a tenant in illegally converted premises asserting a defense of non-payment of rent based on Multiple Dwelling Law ("MDL") §302. MDL §301 provides that a multiple dwelling may not be occupied in whole or in part until the issuance of a proper certificate of occupancy for such residential use. MDL §302(1)(b) provides that the owner of a multiple dwelling which does not have such a certificate of occupancy cannot recover rent and that "no action or special proceeding shall be maintained therefor, or for possession of said premises for non-payment of such rent."

Citing the Court of Appeals decision in *Chatsworth 72nd Street Corp. v. Rigai*,[13] the Second Department acknowledged that "equitable relief [for the building owner] from the strictures of Multiple Dwelling Law §302 is available" in circumstances "where the tenant had prevented the owner from obtaining a residential certificate of occupancy." The issue as to MDL §302 that the court in *Caldwell* stated was presented to it was:

> ...whether the availability of such [equitable] relief [from MDL §302] extends beyond the situation in which the tenant has prohibited the owner from obtaining the necessary certificate [of occupancy], to encompass the situation presented here [in *Caldwell*], in which the tenant merely knew or should have known that the residential tenancy was illegal.[14]

The *Caldwell* court stated that the Appellate Division, First Department had so extended equitable relief from MDL §302, based on that court's view, expressed in *Lipkis v. Pikus*,[15] that "[h]aving entered into possession fully cognizant of the existing realities [i.e., that their occupancy was illegal], tenants should not now be permitted to reap the benefits of occupancy and, at the same time, avoid the payment of rent."

The Second Department disagreed with that view. In approaching the issue, the Second Department relied on cases it had decided involving unlicensed contractors. In those cases, it had strictly enforced the New York City Administrative Code provision forbidding any person to "perform or obtain a home improvement contract as a contractor or salesman from an owner without a license therefor"[16] and had barred unlicensed contractors from recovering, in contract or quantum meruit, for services performed, even where the homeowner knew at the outset of the contractor's lack of a license.

The Second Department cases which the *Caldwell* court cited were *Millington v. Rapoport*,[17] *Fisher Mechanical Corp. v. Gateway Demolition Corp.*[18] and *Hughes Contracting Corp. v. Coughlan*.[19] It specifically quoted its statement in *Millington* that:

> The fact that the homeowner was aware of the absence of a license or even that the homeowner planned to take advantage of its absence creates no exception to the statutory requirement.[20]

The logic of those unlicensed contractor cases, the *Caldwell* court continued, "applies equally to the situation presented here [in *Caldwell*]." It explained:

> Like the licensing statute at issue in *Millington*, Multiple Dwelling Law §302 represents a legislative determination that regulation of particular conduct is necessary.... The Legislature further decided to cast upon the owner the obligation to ensure compliance [with the Multiple Dwelling Law] by expressly depriving the owner of any entitlement to rent or other remuneration in the absence of a certificate of occupancy.[21]

Therefore, the court concluded, "short of a situation such as that presented by *Chatsworth*, 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 [MDL §302] as a defense." Accordingly, the Second Department held in *Caldwell*, the Supreme Court had erred in awarding the owner the value of use and occupancy of the premises pendente lite.

Since the *Caldwell* case was, in part, a declaratory judgment action, the Second Department remitted the matter to Supreme Court, Kings County "for the entry of a judgment declaring that the tenants' apartment is not subject to the protections of ETPA, and that the owner is not entitled to recover for the value of use and occupancy for the duration of the tenants' residency."

In short, the scope of the rights of tenants in commercial premises illegally converted to residential use, in terms of ETPA protection and ability to rely on MDL §302 as a defense to non-payment of rent or use and occupancy, seemingly depends on which side of the Brooklyn Bridge those premises are located.

1. NYLJ, Oct. 29, 2008, p. 31, col. 1 (2nd Dep't).
2. L. 1974, cl. 576 §4, McKinney's Uncons. Laws of New York §8621 et seq.
3. Multiple Dwelling Law Art. 7-C.
4. 2 N.Y.3d 478, 779 N.Y.S.2d 812 (2004).
5. NYLJ, Oct. 29, 2008, p. 31, at col. 3.
6. 35 A.D.3d 232, 826 N.Y.S.2d 221 (1st Dep't 2006).
7. 41 A.D.3d 286, 839 N.Y.S.2d 45 (1st Dep't 2007).
8. Lower court decisions in the First Department, which the *Caldwell* court cited as examples of such a holding include *80 Varick Street Group L.P. v. Nichols*, 18 Misc. 3d 1132(A) (Civ. Ct. N.Y. Co. 2008), *37 West Realty Co. v. Horacio F. Salinas Photography Co.*, 16 Misc. 3d 1122(A) (Sup. Ct. N.Y.Co. 2007), *480-486 Broadway, LLC v. No Mystery Sound Inc.*, 11 Misc. 3d 1056(A) (Civ. Ct. N.Y. Co. 2006), aff'd 16 Misc. 3d 137(A) (A.T. 1st Dep't 2007), and *Korean Am. Assoc. of Greater N.Y. v. Katsukawa*, NYLJ, May 23, 2001, p. 20. col. 2 (Civ. Ct. N.Y. Co.).
9. 18 A.D.3d 812 (2nd Dep't 2005).
10. 39 A.D.3d 656, 835 N.Y.S.2d 261 (2nd Dep't 2007).
11. NYLJ, Oct. 29, 2008, p. 31, at col. 3.
12. Id. at col. 4.
13. 35 N.Y.2d 984 (1975).
14. NYLJ, Oct. 29, 2008, at col. 4.
15. 72 A.D.2d 697 (1st Dep't 1979).
16. Administrative Code §B32-352.0, subd. (a).
17. 98 A.D.2d 765, 469 N.Y.S.2d 787 (2nd Dep't 1983).

18. 247 A.D.2d 579, 669 N.Y.S.2d 347 (2nd Dep't 1998).
19. 202 A.D.2d 476 (2nd Dep't 1994).
20. NYLJ, Oct. 29, 2008, p. 31, at col. 4, quoting 98 A.D.2d at 766, 469 N.Y.S.2d at 788.
21. NYLJ, Oct. 29, 2008, p. 31, at col. 4.

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