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Standard Lease Does Not Shield Landlord in Dispute, Panel Says

BY BEN BEDELL

STANDARD phrasing in an office lease saying a landlord is not responsible for noncompliant certificates of occupancy does not apply to a particular landlord-tenant dispute in Manhattan, an appeals court ruled Thursday.

The Appellate Division, First Department, modified a lower court, holding the tenant's claim for rescission could go forward.

The landlord in the case had relied on a clause stating it "makes no representation that the use of the premises specified herein is consistent with permitted uses under the certificate of occupancy."

But the appeals panel, in a unanimous opinion written by Justice Peter Tom, said the landlord "should not be able to hide behind the 'no representations' clauses included in the lease while at the same time having represented to plaintiff that the premises are suitable for commercial use."

About two years into a five-year lease, the tenant, recruiting company Jack Kelly Partners, discovered the Lenox Hill townhouse where it had rented a floor for office space had a certificate of occupancy restricting the floor to residential use.

Jack Kelly, the company's founder and president, asked the landlord to obtain a corrected certificate. But landlord Elsa Zegelstein declined to seek a change, citing language in the standard form requiring the tenant, at its own expense, to comply with any zoning or building department regulations.

210 East 60th St.

Kelly, who was paying $4,000 a month, vacated the building in May 2009.

According to his attorney, Peter Moulinos of Moulinos & Associates, Zegelstein "kept the $12,000 deposit and threatened to sue for the rent due under the remaining lease term." Kelly then sued, seeking rescission and a declaratory judgment that the lease was no longer binding.

Tom noted precedents holding that "the mere failure of a landlord to obtain a certificate of occupancy before a commercial tenant's date of occupancy does not, without more, give the tenant the right to terminate the lease," citing *Progressive Image Gruppe v. 162 Charles St. Owners,* 272 AD2d 66, 66 (1st Dept. 2000), and a line of cases going back to 1959.

But Tom said those cases were distinguishable because the facts in them made clear "a valid certificate of occupancy could be readily cured, whereas it is unknown from this record whether the certificate of occupancy could be corrected based on zoning or other local ordinances" to allow for commercial use.

Tom also noted that Zegelstein allegedly "advertised and conveyed to the general public that the premises was suitable for commercial use, and the executed lease indicated that only such use was permitted."

Kelly "was not aware that the use intended by the lease as represented by defendants was prohibited by the certificate of occupancy" before signing the lease, Tom added.

Kelly claimed that because city regulations require the flooring in commercial space to withstand a load of 50 pounds per square foot, while a residential space only requires 40 pounds, his employees and guests were at risk.

Manhattan Supreme Court Justice Paul Wooten dismissed Kelly's case in an October 2014, saying the contract clauses were definitive.

But Tom said that "because there are issues of fact as to whether plaintiff's cause of action for rescission of the lease can be proved on the grounds of impossibility, fraud or misrepresentation, and also whether the lease should be terminated based on frustration of purpose, defendants' motion for summary judgment dismissing the amended complaint should not have been granted."

Joining in the opinion in *Jack Kelly Partners LLC v. Zegelstein*, 600351/08, were Justices John Sweeny Jr., Rosalyn Richter and Sallie Manzanet-Daniels.

The standard form used by Zegelstein is published by the Real Estate Board of New York and is widely used in the city, according to real estate specialist Dani Schwartz, a member of Rosenberg & Estis.

"The lesson here is that landlords who specify how commercial tenants can use their leased space should make sure that the use specified in the lease matches up with the building's certificate of occupancy," Schwartz said.

George Sava, of Port & Sava, represented Zegelstein.

"We believed, based on longstanding precedent, that these standard form clauses were bulletproof," Sava said in an interview. "For the First Department to now declare they can be nullified will be disruptive to the commercial real estate industry because it will subject landlords to the litigation costs they thought were obviated by the standard form."

Sava said his client was considering whether to appeal.

In addition to Moulinos, Kelly was represented by Ian Henri, a former associate at Moulinos & Associates.

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