

**THE CO-OP/  
CONDO CORNER**

**CO-OPS HURT BY RULING  
ON HOLDERS OF UNSOLD  
SHARES**

In *Kralik v. 239 East 79<sup>th</sup> Street Owners Corp.* a shareholder of a cooperative owned an apartment as an investment. A dispute arose regarding the shareholder's ability to sublet his apartment without Board consent and his obligation to pay subletting fees to the cooperative. The shareholder contended that he was a Holder of Unsold Shares (a "HUS"), and thus exempt from the cooperative's requirement for Board consent and payment of subletting fees. The cooperative maintained that the shareholder had not complied with all of the regulations promulgated by the New York State Attorney General's office applicable to a HUS. Thus, the co-op's position was that the shareholder had lost his status as a HUS and was therefore subject to all

of the cooperative's requirements.

The New York State Court of Appeals held that the cooperative cannot refuse to recognize the shareholder as a HUS merely because the shareholder failed to comply with the Attorney General's regulations. The Court of Appeals held that the cooperative had no standing to enforce the Attorney General's regulations, and that, as between the cooperative and the shareholder, the only requirements with which the shareholder had to comply were those set forth in the cooperative's proprietary lease and other governing documents. If the shareholder satisfied those requirements, he was a HUS (and, thus, exempt from Board consent and subletting fee requirements) regardless of whether he complied with Attorney General requirements.

**COMMENT**—Many cooperatives still have "Unsold" apartments that are owned by shareholders who bought

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**Special Points  
of Interest:**

- **Effective June 1, 2005, NYS Mortgage Recording Tax is Increased**
- **Condo by-law amendment restricting sale or leasing of studio apartments is upheld.**

**BBW&G Brings Realty Industry Lawsuit  
Challenging Westchester Rent Guidelines Board**

While the Emergency Tenant Protection Act of 1974 ("ETPA") contains specific economic factors that members of the Westchester County Rent Guidelines Board must consider each year in setting the rates for rent stabilized leases, owners keep seeing their operating costs go up, but their rental revenues barely increasing at all. More and more, Westchester's annual RGB

rates seem to reflect little or no relationship to the economic realities of operating and maintaining rent regulated property.

Representatives of the Apartment Owners Advisory Council of Westchester and the Mid-Hudson Region (AOAC), and several owners and managers of ETPA properties, represented by BBW&G's Martin J.

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*The Co-op / Condo Corner*  
*Cont. . . (Cont. from p. 1)*

them as investments. Such investors often claim to be a HUS, since the benefits that are derived from that status (i.e., exemption from Board consent for sales and subletting, exemption from flip taxes and subletting fees, etc.) are significant. Until the decision in *Kralik*, co-op Boards could try to limit the reach of such exemptions by refusing to recognize as a HUS any investor that did not comply with Attorney General Regulations.

However, in light of the *Kralik* decision, co-ops have now lost that ability and must recognize as a HUS any investor who satisfies the standards in the proprietary lease—typically, only that he bought the apartment as an investment and has

not occupied it or had a family member occupy it. Co-ops in this situation are strongly advised to consider amending their proprietary leases to incorporate the Attorney General requirements as necessary for an investor to qualify as a HUS.

### **CONDO BOARDS' RIGHTS BOLSTERED SIGNIFICANTLY**

In *Demchick v. 90 East End Avenue Condominium*, a condominium's adoption of a bylaw amendment restricting the sale or leasing of studio

apartments to owners of larger apartments in the building was upheld by the Appellate Division, First Department in a unanimous decision.

The Court held that such a bylaw amendment, duly adopted by the requisite vote of Unit Owners, was not an unreasonable restraint on the transferability of real estate (a concept going back to the Middle Ages), and, thus, was a permissible exercise by a condominium of its right to regulate transfers of apartments. Curiously, the Court did not

lawfully enact "co-op style" flip taxes, or impose "co-op style" admissions requirements (such as minimum income and asset levels, submission of documentation like tax returns, and interviews of prospective purchasers) or adopt other requirements heretofore alien to condominiums. Under the *Demchick* decision, all that would be required would be that the new provision be adopted as an amendment to the condominium's bylaws, by the requisite unit owner voting process. Condominium Boards

that are interested in pursuing the adoption of any such provisions should consult counsel. However, from a practical perspective, while it appears that Condominium Boards will now have the ability to wield much greater powers, the question is whether doing so will have the effect of closing the traditional "value gap"

between co-op apartments and condo apartments—the anecdotal 10%-30% price differential that arose due to the traditional difference between the control exerted by Condominium Boards when compared with co-op boards, and the concomitant desirability of condominium apartments as investments, including by foreign purchasers. Whether condo apartments will still be perceived as that much more desirable than co-op apartments remains to be seen.

**Under the *Demchick* decision, all that would be required to restrict sales of studio apartments would be that the new provision be adopted as an amendment to the condominium's bylaws, by the requisite unit owner voting process.**

deem the reduction in the number of potential purchasers of studio apartments to only existing Unit Owners of the condominium to be an unreasonable restraint on the ability of a studio owner to sell his apartment.

**COMMENT**—This decision potentially has extremely far-reaching ramifications for condominiums and their unit owners. If a condominium can lawfully restrict sales of particular apartments to existing unit owners only, then condominiums can also probably

*The Co-op / Condo Corner**Cont. . . (Cont. from p. 2)*

## CONDO'S PROHIBITION OF SATELLITE DISH UPHELD

In *Board of Managers of Holiday Villas Condominium I v. Bautista*, a Staten Island condominium sought to enforce against a unit owner regulations in the condominium's House Rules that restricted the location and size of satellite dishes that could be installed by unit owners. A unit owner who had installed a satellite dish on his front patio (in violation of the House Rule's requirement that such dishes be installed only on the upper roof), and whose satellite dish was 33" in diameter (in violation of the House Rule's limit of 18") claimed that the condominium's ability to bar his installation was blocked by FCC regulations adopted by Congress that sought to encourage individual rights to possess new technology like satellite dishes and pre-empted the ability of "community associations" like condominiums from barring their installation.

Staten Island Civil Court Judge Philip Straniere sided with the condominium. Judge Straniere held that, while the federal regulations did pre-empt the ability of a condominium to

bar an individual unit owner from installing a satellite dish, such pre-emption applied only to areas within the exclusive use or control of the individual. The judge ruled that, since the front patio was within the control of the condominium, the federal regulations did not pre-empt the ability of the condominium to place appropriate restrictions on such installations.

**COMMENT**—While this decision favored the condominium, the decision is a narrow one and is based on the location of the particular satellite dish at issue here. Under the federal regulations, a cooperative or a condominium would probably not be able to stop an apartment owner from installing a satellite dish on a private terrace or other area within his exclusive use or control, regardless of any house rule to the contrary. Condominium and cooperative boards are well advised to instruct building staff and management to be vigilant about any such installations and report them to the Board immediately. Boards should consult with counsel to determine if their right to bar any such installation is pre-empted by the federal regulations.

## MORTGAGE RECORDING TAX RATES INCREASED

Effective June 1, 2005, the mortgage recording tax rate imposed by New York State on mortgages in New York City and surrounding counties was increased by \$0.05 per \$100 in mortgage amount. The new tax rates are as follows:

### **In New York City:**

- ☛ 2.05% for all mortgages securing less than \$500,000
- ☛ 2.175% for mortgages of a 1-, 2- or 3-family dwelling, or an individual condominium apartment securing \$500,000 or more
- ☛ 2.80% for all other mortgages securing \$500,000 or more

### **In Nassau, Suffolk, Dutchess, Orange and Putnam Counties:**

- ☛ 1.05% for all mortgages

### **In Westchester and Rockland Counties:**

- ☛ 1.30% for all mortgages (except mortgages of property in Yonkers are taxed at 1.80%)

The increases in these rates should be factored into any budgetary planning by cooperative corporations that are refinancing their underlying mortgages, condominiums that are mortgaging a unit, and individual condominium apartment owners seeking to refinance.

*The Co-op / Condo Corner was written by BBW&G's Aaron Shmulewitz, who represents 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.*



Aaron Shmulewitz

## State's Highest Court Issues Ruling on Calculation of "Legal Regulated Rent"

Owners of rent regulated properties are often confronted with challenges to the rents they charge to their tenants. Determining the "legal regulated rent" of a rent stabilized apartment can sometimes be a complex matter, resulting in protracted and costly litigation. The Legislature tried to address this problem by enacting a four year statute of limitations for all rent disputes (the "Four Year Rule"). In *Thornton v. Baron*, it became a matter requiring review by the State's highest court, with BBW&G representing the owner.

In *Thornton*, an owner entered into a lease agreement with a tenant in 1992 for a rent stabilized apartment. The owner and tenant agreed that the tenant would not use the apartment as his primary residence. The Rent Stabilization Law provides that apartments not occupied as a primary residence are exempt from rent regulation. Based on this provision, the owner—then represented by prior counsel [not BBW&G]—commenced an action in Supreme Court to obtain a declaration that the apartment was exempt from rent stabilization. When the Supreme Court issued a judgment making that declaration, on consent by both the owner and the tenant, the owner believed that the apartment had been legally removed from rent stabilization, and that the market rent it was charging the tenant (\$2,400.00 per month) was lawful.

The tenant, then, sublet the apartment to a celebrity couple who also agreed they would not

occupy the apartment as their primary residence. The subtenants agreed to pay \$3,250.00 per month for their sublet.

In 1996, the subtenants had a change of heart. They sued the prime tenant for rent overcharge, claiming that the apartment was rent stabilized. They complained that the prior rent stabilized tenant had paid \$507.00 per month for the apartment, and now they were being charged more than six times that amount. The subtenants also claimed that they were, in fact, maintaining the apartment as their primary residence.

The subtenants stopped paying rent and allowed their action to lie dormant. In 2000, the owner determined that because the apartment was being occupied as a primary residence, it could no longer maintain the apartment was exempt from rent stabilization. The owner asked the Supreme Court to vacate its prior 1992 consent judgment and allow it to offer a rent stabilized lease to the subtenants.

Over the prime tenant's objections, the Supreme Court granted the owner's motion. In 2001, the tenant's lease was found to be null and void. The Court directed the owner to offer the subtenants a rent stabilized lease in their names. The Court, however, did not make any ruling on what the rent for the rent stabilized lease should be.

The owner complied with the Supreme Court's order. It offered the subtenants their choice of a one or two year rent

stabilized lease. In setting the rent, the owner tried to apply the definition of "legal regulated rent" contained in the Rent Stabilization Code. Based on that definition (as well as an Advisory Opinion the owner had sought from DHCR), the owner determined that the legal regulated rent for the lease offer to the subtenants should be the rent that the owner charged the prime tenant four years earlier, plus additional lawful Rent Guideline Board increases.

When the subtenants received the owner's lease offer, they rejected it. Instead, they added the owner to their long dormant rent overcharge action against the prime tenant. The subtenants claimed that the rent for their new lease in 2001 should be what the predecessor rent stabilized tenant last paid nine years earlier in 1992 (\$507.00).

Ultimately, the Court of Appeals rejected both owner's and subtenants' calculations. In a divided opinion with two dissenting justices, the Court of Appeals in *Thornton* found that while the owner was correct in going back four years to set the rent ("Four Year Base Date"), it was wrong in using the rent charged to the prime tenant on the Four Year Base Date. The Court of Appeals stated that when a lease is invalid on the Four Year Base Date due to an underlying illusory prime tenancy (because the tenant never lived in the apartment), then the "legal regulated rent" for a new lease cannot be based on the amount

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***State's Highest Court Issues******Ruling . . .****(Cont. from p. 4)*

charged to that tenant under the invalid lease. Instead, the Court held that the legal regulated rent must be calculated by using a "default formula" that looks at the lowest registered rent on the Four Year Base Date for a rent stabilized apartment in the building with the same number of rooms.

The Court of Appeals decision was striking for two reasons. First, as the dissenting justices observed, the Court did not adhere to the plain language in the rent laws, which sets a strict four year statute of limitations for all rent disputes (the "Four Year Rule"). It was, thus, inconsistent with the Four Year Rule to consider the circumstances of the tenancy before the Four Year Base Date in order to conclude that the rent charged on that Date was not binding. By definition, all statutes of limitations can result

in alleged wrongdoers escaping penalty. There was no factual or legal basis for creating an exception to the clear and emphatic statute of limitations in the Four Year Rule when the dispute involved a rent stabilized apartment.

Second, there seemed to be no basis for using a "default formula" when the actual rent charged on the Four Year Base Date was known. The use of such a "default formula" unduly benefited the subtenants who were knowing and sophisticated participants in all aspects of the underlying tenancy.

Thus, the majority agreed with the owner that the Four Year Rule must be adhered to. However, because of the fact based situation, and the presence of what was found to be an illusory tenancy, the Court did not simply adopt the rent charged to the prime tenant four years before, but looked to a "default formula" to calculate the initial rent. Conversely, the

subtenant's position, that the Four Year Rule should be abandoned, with the rent rolled back more than a decade was rejected by all of the justices.

All in all, the *Thornton* decision is a bit of a mixed bag, by a markedly divided Court. Perhaps, if anything, this decision indicates that although the Four Year Rule is firmly in place, the rent that will be relied upon on the Four Year Base Date may be impacted by an unusual set of facts and circumstances.

*This article was written by Magda L. Cruz, who argued the Thornton case before the Court of Appeals.*



**Magda L. Cruz**

***Westchester Rent Guidelines Board . . .****(Cont. from p. 1)*

Heistein and Magda Cruz, recently brought an action in the State Supreme Court against the Westchester County RGB to try to compel the members of the RGB to comply with the requirements of the ETPA. Similar to an earlier lawsuit brought by a tenants group against the Nassau County RGB (*Matter of New York State Tenants & Neighbors Coalition, Inc. v. New York State Div. of Housing & Community Renewal*), the Westchester lawsuit sought to

have the RGB justify its annual guidelines with sound empirical data.

While the New York State Division of Housing and Community Renewal (which has jurisdiction over the RGB in both Westchester and Nassau counties) has argued that such lawsuits should be dismissed because the RGB has broad discretion in issuing guidelines, the Appellate Division in the Second Department in the Nassau County case disagreed, sending the case back to the Supreme Court for the RGB to issue meaningful findings in

compliance with the ETPA.

While the ultimate outcome of these cases are still unknown, it appears that the courts are becoming less willing to simply allow state officials *carte blanche* in setting annual rent guidelines affecting tens of thousands of regulated apartments outside the City of New York.

*This article was written by Magda L. Cruz, who along with Martin J. Heistein represents the Westchester owners in the above-described litigation.*

## BBW&G NEWS

### MAY I QUOTE YOU?

**Aaron Shmulewitz**, a partner in BBW&G's Transactional Department, addressed an inquiry in *The New York Times* "Q & A" column concerning a unit owner wishing to sublet, but having been advised by the condo board that there were fees associated with subleasing, as well as a requirement that a sublease be submitted. Mr. Shmulewitz stated that subleasing is governed by the bylaws and house rules of the condo. Therefore, determining if the requirements that the board was imposing were proper or not, required an examination of those documents.

In another "Q & A" column, Mr. Shmulewitz explained that the monthly maintenance payments for co-ops are generally higher than a comparable condo's monthly common charges due to the underlying mortgage on most co-ops, as well as the assessment of real estate taxes against the cooperative corporation (as opposed to the direct payment of such taxes by unit owner in a condo).

In *The New York Times*'s article "Court Backs Condos on Sale Restrictions" by Jay Romano, Mr. Shmulewitz also discussed a recent decision by the Appellate Division in *Demchick v. 90 East End Avenue*, where the appellate court upheld an amendment to the condo's bylaws that prohibited sales or leasing of certain apartments to anyone other than current owners. Mr. Shmulewitz stated: In my opinion, the decision is a radical departure from previously prevailing notions of a condo's rights and powers. There is no question that this decision opens the door to condos being able to impose conditions for sales and leasing that are more akin to those typically imposed by co-ops.

Mr. Shmulewitz was also quoted in *The New York Times* article concerning the arrest of a former resident of an Upper East Side co-op, who had served as the co-op's treasurer, and had not accounted for certain co-op funds, as well as monies that neighbors had given for investment purposes.

**Martin Heistein**, a partner in BBW&G's Administrative Law Department was quoted in *The Journal News*' article "Landlords Sue Rent Guidelines Board." Mr. Heistein, representing the Building and Realty Institute of Westchester, noted that "The point of the lawsuit is to take the decision making process out of the political realm as much as possible." The lawsuit claims that the Board's decision making has been skewed against owners and fails to adequately explain how its decisions are reached.

*The Apartment Law Insider* examined the rights and obligations pertaining to owner occupancy proceedings. **Magda Cruz**, who handles BBW&G's appellate matters, noted that the standard for recovery of rent stabilized apartments for owner occupancy purposes is whether the owner is acting in "good faith" – not that the owner had a compelling necessity, which is the standard for recovery of rent controlled apartments. Ms. Cruz also described the manner in which the building must be owned, the time frame for service of a non-renewal notice (upon rent stabilized tenants) and the special rules that apply to senior citizens, disabled persons and rent controlled tenants in occupancy for 20 years or more.

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**BBW&G News***(Cont. from p. 6)*

In “Everybody Out” *The New York Times*’s Dennis Hevesi described a situation where an owner was seeking to evict all of its rent stabilized tenants based upon “owner occupancy” to create a large single family residence. **Sherwin Belkin** of BBW&G’s Administrative Law Department addressed the respective rights of the parties: “It needs to be remembered that an owner owns his or her building and has a constitutional right to reside in that property. A tenant, on the other hand, has a privilege to occupy. And rights are superior to privilege.”

Mr. Belkin also addressed a subtenant’s concern that his occupancy might be jeopardized because the owner was contesting the prime tenant’s right to renew. Mr. Belkin stated that because a sublease is subordinate to a prime lease, “if the prime tenant loses his renewal right, then the sublease would come to an end and the letter writer can be evicted.” As to the subtenant’s question concerning his remitting his rent payments directly to the owner, Mr. Belkin stated: “If I were advising the landlord, I would tell him never to accept rent from the subtenant, since the landlord’s only legal relationship is with the prime tenant.”

Mr. Belkin’s description of the Luxury Deregulation process and its ramifications was printed in the “Townhouse Newsletter” prepared by broker and townhouse specialist Wolf Jakubowski, of Brown Harris Stevens.

Mr. Belkin’s article in BBW&G’s June 2005 *UPDATE* (“Required Services: A Result of Lease, License or Law” –regarding a recent decision by the Appellate Division, First Department, that could impact the nature of “required services” under the Rent Stabilization Law) was re-printed in the August 2005 edition of the New York Association of Realty Managers magazine.

The “Downtown Express” described DHCR having granted owner Henry Meer’s application to refuse to renew a lease based upon an intention to demolish. BBW&G’s **Kara Rakowski** noted: “The owner’s position is supported by the Rent Stabilization Code, case law and DHCR precedent. This is not the first application that the DHCR has granted to permit an owner not to renew a tenant’s lease based on its intent to demolish the building. This is not out of the ordinary.”

**Craig Price** of BBW&G’s Transactional Department participated in a panel discussion addressing the purchase, sale, financing and tax consequences associated with co-ops, condos and single family homes.

The Court of Appeals decision involving the pop star Cyndi Lauper (*Thornton v. Baron and 390 West End Associates*) received intense media coverage. As described in this issue of *Update*, the appeal argued by BBW&G’s **Magda Cruz**, resulted in a split decision which did not set the legal regulated rent as high as the owner was seeking, or as low as demanded by Ms. Lauper (a/k/a Thornton). Instead, due to the unique circumstances presented by the parties, the Court adhered to the “4 year rule” but relied upon a default formula on the 4-year base date for the setting of the rent. This appeal was noted on NY1, 1010 WINS, ABC-7, E-Online, Fox News, The New York Times, The New York Post, The Daily News, WNBC.com, CNN.com, and endless other media outlets. Who knew that so many people were fascinated by the Rent Stabilization Law?

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**Legal Update**

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