Matter of Equinox SC Upper E. Side, Inc. v Vertical Projects, LLC
2017 NY Slip Op 32490(U)
November 22, 2017
Supreme Court, New York County
Docket Number: 653313/2017
Judge: Saliann Scarpulla

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 39

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EQUINOX SC UPPER EAST SIDE, INC.

Plaintiff,

- v -

VERTICAL PROJECTS, LLC,

Defendant.

INDEX NO. 653313/2017

MOTION SEQ. NO. 001

DECISION AND ORDER

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The following e-filed documents, listed by NYSCEF document number 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77, 78, 81

were read on this application to/for PARTIAL SUMMARY JUDGMENT.

HON. SALIANN SCARPULLA:

Plaintiff Equinox SC Upper East Side ("Equinox"), the tenant under a long-term "triple net" operating lease with defendant Vertical Projects, LLC ("Vertical"), the owner and landlord of the property located at 330 East 61st Street and 333 East 60th Street in Manhattan ("Property"), commenced this action seeking to compel Vertical to consent to a proposed sublease that is conditioned upon a mandatory change in the Property's zoning classification.

Equinox now moves, pursuant to CPLR § 3212, for an order granting it summary judgment: (1) on the third cause of action in the complaint declaring that Vertical's

withholding of consent to Equinox's proposed subtenant is unreasonable as a matter of law, and that such consent is deemed to be given; and (2) dismissing Vertical's third counterclaim seeking a declaration that Vertical reasonably withheld its consent to Equinox's proposed subtenant and lease.

Vertical cross-moves, pursuant to CPLR §§ 2215 and 3212, for summary judgment dismissing all claims against it, and denying Equinox's motion for summary judgment.

Background

Vertical owns the Property, which contains a five-story commercial building comprised of approximately 119,000 rentable square feet ("Building"), and Equinox currently rents the Building. Equinox and Vertical are parties to the Amended and Restated Net Operating Lease ("Lease") dated as of March 26, 1985 between Hirschfeld Realty Club Corporation and 328 E. 61 Corp. ("Vertical's predecessors-in-interest"), as landlord, and Vertical Fitness and Racquet Club, Ltd. ("Equinox's predecessor-in-interest"), as tenant. Through an Assignment and Assumption Agreement, dated July 30, 2014, Equinox acquired the rights of MP Sports Club Upper Eastside LLC, the successor-in-interest to Vertical Fitness and Racquet Club, Ltd., to the Lease.

Equinox operates an upscale full-service center for health, fitness and sports at the Building. The original term of the Lease expired on September 30, 2001. Equinox has exercised all remaining renewal options, and the Lease is currently set to expire on December 31, 2030.

Section 10.02 of the Lease grants Equinox substantial control over the entire Building:

> "Except as otherwise provided herein, Tenant shall fully and exclusively control the Demised Premises and be responsible for the condition, operation, repair, replacement, maintenance and management of the Demised Premises"

Section 3.01 of the Lease also permits Equinox to change the use of the Building, if the use is for "any lawful purpose, including without limitation, as a tennis and sports complex, health spa, office space, restaurant, night club, cabaret, garage, and for the sale of sports and fitness equipment, health foods, vitamins and juices".

In addition, section 6.04 of the Lease grants Equinox the right at any time to make structural and non-structural alterations to the Building that are consistent with the uses (and change in uses) permitted under the Lease, without Vertical's prior consent. However, section 6.04 (vi) of the Lease adds that Equinox is unable to make changes that will "diminish the value of any building comprising a part of the Demised Premises." Section 6.04 (vi) contains no reasonableness or any materiality limitations.

Section 18.05 of the Lease expressly entitles Equinix to assign and/or sublet all or a portion of the entire Building "[w]ith [Vertical]'s prior written consent, which consent may not be unreasonably withheld[.]" Thus, section 18.05 provides Vertical with the right to withhold consent to any proposed sublease, provided that it does so reasonably.

On October 17, 2000, Equinox's predecessor-in-interest obtained a variance from the New York City Board of Standards and Appeals ("BSA") to allow for the Building to be used as a health club "physical culture establishment" ("PCE"). On May 3, 2011, the BSA granted an extension for the variance permitting the PCE use to continue until October

17, 2020. The Building is currently classified as a "Use Group 6E (Club)" under the New York Zoning Resolution.

In late 2016, Equinox began negotiating with The Hewitt School and the Browning School ("Subtenant"), two well-known Upper East Side private schools, for the sublease of approximately 55,000 square feet of space in the Building ("Subleased Premises"), for a period of ten years, with an option to extend the sublease for an additional three years ("Proposed Sublease"). Subtenant intends to use the Subleased Premises as an athletic facility for the students and faculty of the schools.

On January 17, 2017, Equinox notified Vertical of its intention to sublease a portion of the Building to the Subtenant, and requested that Vertical provide its consent, pursuant to section 18.05 of the Lease. Over the next few months, Equinox and Vertical engaged in a series of communications, in which Vertical sought information to evaluate the Proposed Sublease. Vertical noted that the Proposed Sublease is "subject to and conditioned on" Equinox's receipt from the BSA of a change in the Building's zoning classification, pursuant to which both the PCE and Use Group 6E classifications must be surrendered and replaced with a Use Group 9A "gymnasium" classification.

On April 10, 2017, Vertical formally denied consent ("Denial Letter"). Vertical contends that its zoning and land use experts have advised it that, under the New York Zoning Resolution, a Use Group 9A classification would require the Building to be used exclusively for basketball, handball, paddleball, racquetball, squash and tennis. According to Vertical's experts, this mandatory change in zoning, as required by the Sublease, will diminish the value of the Building – by substantially limiting its possible uses and severely

restricting its marketability – in violation of section 6.04 (vi)'s prohibition against Tenant Changes which diminish the value of the Building. Vertical further contends that its zoning and land use experts have advised it that there is no assurance that, at the end of the Lease, Vertical would be able to reinstate the Use Group 6 classification, as such BSA action would be purely discretionary. Vertical asserts that, because of this provision, it cannot consent to the Proposed Sublease without also consenting to the zoning change.

By letter dated July 28, 2017 to Equinox's counsel, Vertical's counsel tendered complete mitigation:

> "Landlord hereby offers to mitigate any and all alleged damages by subletting the Sublet Space from [Equinox] on the same terms as those contained in the Sublease (i.e., Fixed Rent, abatement, Tenant's construction obligations, etc.). Since the Landlord will not itself occupy the Sublet Space, the Landlord would receive rights customarily granted landlords in these circumstances including the freedom to underlease the Sublet Space"

In response to Equinox's concerns that the mitigation proposal did not fully protect it, by letter dated August 9, 2017, Vertical advised Equinox that it "acknowledges and appreciates Equinox's concern that its business not be unreasonably adversely affected by any further sublease and agrees to work with Equinox on language that reasonably protects both parties on this issue."

On June 16, 2017, Equinox filed the complaint in this action, asserting four causes of action: (1) breach of contract; (2) breach of the implied covenant of good faith and fair dealing; (3) declaratory judgment that Vertical's withholding of consent to the Subtenant is unreasonable, and deeming Vertical to have consented to the Subtenant pursuant to § 18.05 of the Lease; and (4) permanent injunctive relief.

On July 19, 2017, Vertical filed an answer, denying Equinox's substantive allegations and asserting affirmative defenses, as well as a counterclaim for declaratory judgment that it reasonably withheld its consent to the proposed Sublease and Subtenant.

On July 27, 2017, Equinox filed a reply and affirmative defenses to the counterclaim, denying the substantive allegations set forth in the counterclaim.

The causes of action in this suit, as well as the counterclaim, are dependent upon the core issue of whether Vertical reasonably or unreasonably withheld its consent to the Proposed Sublease.

Discussion

A grant of summary judgment is appropriate when the interpretation of a contract is dispositive of the issues in the case. *See Gen. Elec. Capital Corp. v Volchyok*, 2 A.D.3d 777, 778–79 (2d Dep't 2003) (citing *Hartford Acc. & Ind. Co. v. Wesolowski,* 33 N.Y.2d 169 (1973)). Further, pursuant to CPLR § 3001, I am authorized to render a "declaratory judgment" as to the rights and other legal relations of the parties, provided that a "justiciable controversy" exists, irrespective of whether further relief is or could be claimed. Here, a justiciable controversy exists between Equinox and Vertical as to whether Vertical is reasonably or unreasonably withholding its consent as to Equinox's proposed subtenant, pursuant to the Lease's terms and conditions.

As more fully set forth below, I find that neither party is entitled to summary judgment.

It is undisputed that, pursuant to section 18.05 of the Lease, Vertical has the right to withhold its consent to any proposed sublease, provided it does so reasonably, and that

section 6.04 (vi) of the Lease prohibits Equinox from making changes that diminish the value of the Building. It is also undisputed that the Proposed Sublease is expressly subject to and conditioned upon a mandatory change to the Building's zoning classification to a "gymnasium" under Use Group 9A.

Equinox argues that its motion must be granted because, as the tenant under a long-term "triple net lease," the Lease unambiguously permits the Building to be used for "all lawful purposes," and because Equinox has near absolute control over the Building and its use during the Lease term. Equinox contends that Vertical's right under the Lease to withhold its consent to a proposed subtenant is extremely limited, and thus, Vertical may not reasonably withhold its consent based on a concern over a diminution in value.

Conversely, Vertical argues that its consent was reasonably withheld because, in violation of section 6.04 (vi) of the Lease, the mandatory zoning change will result in a substantially devalued Building as the available uses and marketability will be substantially restricted as a "gymnasium." Vertical contends that the magnitude of that reduction in value is approximately $56 million, based on the difference between the rent that Vertical could expect to charge to a "gymnasium" tenant, using the rent payable to Equinox under the sublease as a benchmark, compared with what it could charge for the office space as would otherwise be permitted under Use Group 6.

First, I do not find persuasive Equinox's assertion that under the Lease it is entitled to use the Building for "any lawful purpose," regardless of whether such use may ultimately diminish the value of the Building. Under established principles of contract construction, "[a] lease is to be interpreted as a whole and construed to carry out the parties' intent,

gathered, if possible, from the language of the lease'" *Cobalt Blue Corp. v 184 W. 10th St. Corp.*, 227 A.D.2d 50, 53 (1st Dep't 1996). Moreover, a lease "should not be interpreted in a way that would leave one of its provisions without force or effect" *350 E. 30th Parking, Ltd. v Bd. of Managers of 350 Condominium*, 280 A.D.2d 284, 287 (1st Dep't 2001).

Under these principles of contract construction, Equinox's interpretation of the Lease would completely read out section 6.04 (vi) of the Lease, which expressly prohibits Equinox from undertaking any Tenant Change that has the effect of diminishing the value of the Building. Thus, although section 3.01 of the Lease permits the use of the Building "for any lawful purpose," that section co-exists with section 6.04 (vi), showing that certain "lawful uses" that would diminish the value of the Building are prohibited.

The question then becomes whether Vertical acted reasonably in withholding its consent based on its belief that it will receive a devalued property at the end of the Lease because of mandatory zoning changes contemplated by the Proposed Sublease.

Under New York law, the reasonableness of a landlord's decision to withhold consent is determined based on what an objectively reasonable landlord would do if confronted with the same facts and circumstances. *See Astoria Bedding v Northside Partnership*, 239 A.D.2d 775, 776 (3d Dep't 1997) ("[W]here a landlord affirmatively promises not to unreasonably withhold its consent, its refusal can only be based upon a consideration of objective factors"). Thus, "subjective concerns and personal desires could not play a role in a landlord's decision to withhold its consent" *Logan & Logan, Inc. v Audrey Lane Laufer, LLC*, 34 A.D.3d 539, 539 (2d Dep't 2006).

Given the limitation set forth in section 6.04 (vi) of the Lease, if Vertical could make a *prima facie* case that the Building would be meaningfully devalued at the end of the Lease because of the Proposed Sublease, an objectively reasonable landlord would plainly refuse to consent to such a sublease. However, based upon the record before me, I find that there is a factual issue as to whether the proposed use of the space by the schools will meaningfully diminish the value of the Building at the end of the Lease term, and thus, whether Vertical's refusal to consent to the Proposed Sublease was objectively reasonable. *See Logan & Logan, Inc. v Audrey Lane Laufer, LLC*, 34 A.D.3d 539, 540 (2d Dep't 2006) (finding "a triable issue of fact as to whether the defendant landlord withheld its consent to the proposed assignment based on objective concerns, and thus whether its withholding of consent was reasonable").

Although Equinox contends that this "diminution in value" assertion is entirely self-serving and speculative, Vertical submits affidavits from zoning and land use experts, including the affidavit of Karl A. Griggs, Senior Executive Director of Hirschfeld Properties, and the affidavit of Howard Goldman, a zoning attorney. In sum, both provide a detailed analysis of the diminution in value that the Building would suffer if the zoning classification were changed. In response to these affidavits, Equinox submits the affidavit of Sital Patel, the principal architect in charge of the proposed development of the Subleased Premises, in which Patel challenges Goldman's opinion, and asserts, *inter alia*, that the schools' proposed use will increase the density of development allowed within the

Building, and will thus not impair the value of the Building. These competing affidavits underscore the factual issues surrounding the diminution of value issue.

Under these circumstances, a framed issue hearing is required to determine whether the mandatory zoning changes contemplated by the Proposed Sublease will result in a diminution of value of the Building, and thus, whether Vertical has unreasonably withheld its consent to the Proposed Sublease. *See Barbara Anne, Inc. v Smithhaven Ctr. Assoc., LLC*, 273 A.D.2d 331, 331 (2d Dep't 2000) (lower court directed hearing on the issue of reasonableness of landlord's refusal to relocate site of plaintiff's kiosk). These issues will be referred to a special referee to hear and report.

The court has considered the remaining arguments, and finds them to be without merit.

In accordance with the foregoing, it is

ORDERED that a hearing shall be conducted before a Special Referee on the issues of whether the mandatory zoning changes contemplated by the proposed sublease will result in a diminution of value of the building at issue in this action. The Special Referee is to report to this Court with recommendations, except that, in the event of and upon the filing of a stipulation of the parties, as permitted by CPLR § 4317, the Special Referee, or another person designated by the parties to serve as referee, shall determine the aforesaid issues; and it is further

ORDERED that counsel for defendant or counsel for the plaintiff shall, within 30 days from the date of this order, serve a copy of this order with notice of entry, together with a completed Information Sheet, upon the Special Referee Clerk in the Motion Support

Office, who is directed to place this matter on the calendar of the Special Referee's Part (Part 50R) for the earliest convenient date; and it is further

ORDERED that both the motion and the cross motion are held in abeyance pending receipt of the Special Referee's report, and the motion and the cross motion shall be disposed of in accordance with the results of the Special Referee's report and this decision.

This constitutes the decision and order of the Court.

11/22/17
DATE

SALIANN SCARPULLA, J.S.C.

CHECK ONE:		CASE DISPOSED			X	NON-FINAL DISPOSITION	
		GRANTED		DENIED		GRANTED IN PART	X OTHER
APPLICATION:		SETTLE ORDER				SUBMIT ORDER	
CHECK IF APPROPRIATE:		DO NOT POST				FIDUCIARY APPOINTMENT	REFERENCE