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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: ALICE SCHLESINGER Justice

PART IA PART 16

Index Number : 102833/2012
HELLER REALTY
VS.
NYS DIVISION OF HOUSING
SEQUENCE NUMBER : 001
ARTICLE 78

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

The following papers, numbered 1 to _____, were read on this motion to/for _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). _____

Answering Affidavits — Exhibits _____ | No(s). _____

Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this ~~motion is~~ Article 78 proceeding is denied and the proceeding is dismissed in accordance with the accompanying memorandum decision.

UNFILED JUDGMENT

This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

JUL 15 2013

Dated: July 15, 2013

ALICE SCHLESINGER, J.S.C.

1. CHECK ONE: ..... ☒ CASE DISPOSED ☐ NON-FINAL DISPOSITION

2. CHECK AS APPROPRIATE: .....MOTION IS: ☐ GRANTED ☒ DENIED ☐ GRANTED IN PART ☐ OTHER

3. CHECK IF APPROPRIATE: ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER

☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 16

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In the Matter of the Application of
HELLER REALTY,

Petitioner,

Index No. 102833/12
Motion Seq. No. 001

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules,

-against-

NEW YORK STATE DIVISION OF HOUSING AND COMMUNITY RENEWAL,

Respondent,

-and-

TONI LEVI,

Intervenor-Respondent.

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SCHLESINGER, J:

The issue in this case is whether respondent New York State Division of Housing and Community Renewal (DHCR) properly determined the effective date of a rent increase it granted to the owner based on certain major capital improvements (MCI) completed at the building. The petitioner here is the managing agent for the holder of unsold shares appurtenant to seven apartments in the building, a cooperative located at 105 West 73rd Street in Manhattan. Three of the seven affected apartments are subject to the Rent Stabilization Law of 1969 and four are subject to the New York City Rent and Rehabilitation Law, commonly known as Rent Control, but only the effective date for the four rent-controlled tenants is challenged here. The petition, which seeks to make the rent increase retroactive to November 1, 2006, is opposed by DHCR and the intervening rent-controlled tenant Toni Levi, both of whom assert that the agency correctly set an effective date of May 1, 2012. While the issue is narrow, the additional rent increase sought by petitioner amounts to a substantial sum of money for the mostly senior citizen tenants.

Background Facts

On or about October 6, 2003, petitioner filed an application with DHCR seeking an MCI rent increase in the amount of $53.68 per room, per month, in perpetuity, for seven rent-regulated apartments at the building. The subject improvements completed in September 2002 consisted of exterior restoration work at a cost of $600,101.06 and related engineering fees totaling $49,212.62. (Admin Return, A-1)[1]. The agency's Administrative Return, which documents the proceedings, begins with various requests by DHCR's District Rent Administrator (DRA) for information from the owner, objections to the MCI by the tenants, and various comments by the owner (A-2 through A-15).

The first exchange relevant to the issues here appears in the Return at A-16. Of particular significance there is the August 19, 2004 notice from the DRA to the owner indicating that the owner had failed to reply to a July 21 notice and giving the owner one final opportunity to reply. The notice lists seven specific questions, six of which relate to the building's status as a cooperative, whether the sponsor had paid for any part of the improvements, whether reserve funds had been used for payment, whether the cooperative shareholders had been charged a special assessment for the MCI work, and whether the sponsor had made any representations in the offering plan about payments for the work.

The DRA's inquiry was indisputably appropriate in light of two facts: the copies of the checks submitted by the owner as proof of payment were from an account entitled

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[1] The Administrative Return supplied by DHCR includes an application with two date stamps, October 6, 2003 and December 18, 2003, and the petition (¶ 9) includes a third date of January 28, 2004. The discrepancy is not explained, but it is not relevant to the issues here.

"105 West 73rd Owners Corp. Reserve Fund"; and rent regulations expressly prohibit the award of an MCI rent increase "to the extent that, after a plan for the conversion of a building to cooperative or condominium ownership is declared effective, such improvement is paid for out of the cash reserve fund of the cooperative corporation ...." Rent Stabilization Code § 2522.4(a)(9).

Also noteworthy is the fact that the application was filed by Heller Realty, which is the managing agent for the holder of the unsold shares allocable to the apartments and not the actual owner. All the contracts for the MCI work are in the name of 105 West 73rd Owners Corp., which apparently is the cooperative corporation that owns the entire building, and that entity's name is on all the checks issued for payment here; the legal owner of the unsold shares who is seeking the rent increase here is not separately identified. However, to be consistent with the terminology used by DHCR, this Court will refer to the agent Heller Realty as "the owner."

Although well aware of the significance of the reserve fund issue, the owner responded to the DRA's request for additional information with only a brief letter dated September 9, 2004, signed by a legal assistant at counsel's firm. The letter simply stated in conclusory fashion that: the sponsor did not pay for the improvements or commit in the plan to pay for them; "Reserve funds were not used to pay for the improvements during the initial offering phase or after the plan was declared effective," no amount was credited against the reserve fund; no special assessment was charged to the shareholders for the work; and the sponsor did not indicate in the plan that it would bear the full cost of the work. (A-16). No details were provided. It was later confirmed that the plan had been declared effective in March of 1989. (A-22).

What followed was the submission of objections from various tenants and the owner's response. The only comment relevant here was the assertion by various tenants that the sponsor had agreed to make certain improvements when seeking approval of the plan, but the owner claimed in response that the tenants had not pointed to any such written agreement in the plan. Beyond that, the proceeding was delayed by the owner's filing of a request for records under the Freedom of Information Law and its repeated requests for extensions of time to supply certain information requested by the DRA regarding the contract, room count, and other issues. (A-23 to A-49). The only additional piece of evidence offered relevant to the dispute here was bank statements from the owner confirming that payment for the improvements had been made from an account entitled "105 West 73rd Owners Corp Reserve Fund." (A-46).

The DRA issued its Order Denying MCI Rent Increase on October 10, 2006. (A-50). Consistent with RSC § 2522.4(a)(9) quoted above (at p 3), the stated basis was:

> THE MCI IMPROVEMENTS WERE PAID FOR WITH MONEY FROM THE COOP RESERVE FUND. THE COPIES OF CANCELED CHECKS AND BANK STATEMENTS SUBMITTED INDICATE THAT RESERVE FUNDS WERE USED.

The owner timely filed a Petition for Administrative Review (PAR) on November 13, 2006. (B-1).The owner acknowledged that the bank statements and checks provided as proof of payment indicated that the improvements had been paid for from an account entitled "105 West 73rd Owners Corp Reserve Fund." The owner argued, however, that the DRA should not have given weight to those documents in light of the fact that a legal assistant at counsel's firm had indicated in a letter that no reserve funds had been used. The owner added that the DRA was on notice that the plan had been

declared effective in 1989, about 11 years before the MCI work was completed, making it unlikely that the reserve fund would have contained enough money to pay for the substantial improvements. The only documents provided in support of the PAR were the DRA's August 19, 2004 request for information and the legal assistant's brief September 9, 2004 letter in response, both of which were discussed above.

The tenants opposed the PAR by, among other things, providing copies of sections from the offering plan where the owner had agreed to make certain improvements. They asserted that these plan provisions (which they say they had previously provided to the DRA), coupled with the checks and bank statements labeled "Reserve Fund", supported the DRA's denial of the rent increase. (B-2, B-3). Again, the owner obtained multiple extensions of time to reply (B-4). Finally, on May 30, 2007, the owner submitted its response (B-5).

There, in a letter from counsel, the owner further addressed the sponsor's obligations under the offering plan: according to ¶ 8 of the offering plan, the sponsor agreed to make certain specified improvements (which included roof repairs but not exterior restoration), to deposit $100,000 in escrow at the closing for that purpose, and to assume any cost beyond that, without waiving his right to seek an MCI increase from the rent-regulated tenants; and ¶ 9, entitled "Capital Reserve Fund," provided that the sponsor would also contribute $210,000 to the Reserve Fund at closing. According to counsel, neither of these provisions supported the tenants' assertion that either sponsor money or Reserve Fund money was used 11 years later to pay for the exterior restoration work in excess of $400,000 that is at issue here.

The owner then briefly addressed the fact that all the cancelled checks and the bank statements proving payment for the MCI work were drawn on an account entitled "Reserve Fund." Without providing any evidentiary support or a statement from an individual with personal knowledge, counsel simply stated: "Once the [reserve] funds were depleted, the cooperative converted the reserve fund bank account into another operating account. As such, all payments made by the coop in connection with the MCI work, although paid out of the account still named 'reserve fund', were not paid from statutory reserve funds." Rather than reject the claim as unsubstantiated, DHCR wrote to the owner on March 16, 2011 and gave them an opportunity to supply proof. (B-7).

After obtaining yet another extension of time to respond (B-8), the owner responded on August 8, 2011, providing a letter from Michael Dinkes, JD, CPA, dated July 22, 2011 (B-9). After confirming the 1989 effective date of the plan and the 1999 commencement date of the MCI work, Mr. Dinkes simply stated in the letter that : "Based upon my review of the Cooperative's Balance Sheets from 1988 to 1999, it is clear that the original Reserve Fund, consisting of $210,000, had been fully depleted by the time the exterior restoration work commenced such that none of the original Reserve Fund money was used to pay for any portion of the work."

The referenced balance sheets were not provided. Nor did the letter address the possibility that other monies were paid into the Reserve Fund at some point in time and used for the exterior restoration work. Further, like counsel's May 30, 2007 letter discussed above, the Dinkes letter indicated that the improvements had been paid for by the cooperative corporation that owns the building. However, neither letter specified the amount paid by or attributable to the owner of the unsold shares alllocable to the seven rent-regulated apartments who is seeking the rent increase here.

In addition to the Dinkes letter, counsel provided his own letter on August 8 (B-10). There, notwithstanding express language in the regulation to the contrary, counsel argued that it was "irrelevant' that the checks used for MCI payments were drawn on a "Reserve Fund" account. He further argued that, based on the numbers, it was "impossible" that reserve fund monies were used. DHCR forwarded that correspondence to the tenant for response on September 14 (B-11).

Without obtaining even one extension of time, Toni Levi, the intervening tenant herein, replied by letter dated October 3 on behalf of herself and other rent-regulated tenants (B-12). The tenants challenged the accuracy and validity of the Dinkes letter, noting that it was unsworn and that the owner has "submitted absolutely no documentary evidence" to support the claim that no reserve fund money had been used (emphasis in original). She questioned the conclusory claim that the substantial reserve fund monies had been depleted, when the cost of improvements to the elevator, roof and water tank had been less than $60,000 and a working capital fund had also been available for repairs.

The tenants further challenged the owner's assertion that the sponsor had not paid for any part of the cost of the improvements. They suggested that the holder of the unsold shares (i.e., the "owner" of the rent-regulated apartments) was, in fact, the sponsor, and they questioned his right to recoup the cost of the improvements via an MCI rent increase if the sponsor had not paid for the improvements as claimed. And if the sponsor had not paid, and the cooperative Reserve Fund had not been used, then the question remained as to who had supplied the money for the improvements that had been paid for on an account that directly referenced the cooperative's Reserve

Fund and that Dinkes had identified as belonging to the cooperative. The tenants sent additional comments on November 28, 2011 (B-13), reiterating their point about the lack of documentation and complaining about the repeated extensions of time given to the owner's counsel.

The tenants' points did not go unheeded. On December 7, 2011, the Director of DHCR's Administrative Review Unit requested that the owner provide additional proof:

> An actual accounting of expenditures from the reserve fund has not been submitted. Please submit a statement from the CPA who has reviewed the co-op balance sheets which provides an itemized breakdown of expenditures by date from the reserve fund documenting that the initial cash reserve which was funded by the sponsor of the co-op Offering Plan had been depleted prior to the onset of the MCI work.

In response, the owner requested an extension through February 27 — nearly sixty days from the date of the letter — to respond. (B-15). On February 23, the DHCR clarified that it would accept a "statement from the CPA accompanied by copies of annual balance sheets showing the beginning and ending balance in the reserve fund account for each relevant year." (B-16). Noting that the documentation should be "readily available" as the CPA had presumably reviewed it for his prior letter, the agency requested a timely response.

The response came by letter dated March 23, 2012. (B-17). In addition to counsel's letter reiterating previous points, Mr. Dinkes provided a letter indicating year by year how much money had been spent from the reserve fund, and he calculated that the original $210,000 deposited by the sponsor had been depleted by the time the MCI work was begun. He also provided the balance sheets he had reviewed. Further, and significantly, he acknowledged that additional amounts had been deposited into the

reserve fund account over the years, but he said that those monies, "resulting from loans and refinancing, are not original 'reserve fund' money and could have been deposited into any other account opened by the Cooperative Corporation." Meaning what? Since that bank account was the one used to pay for the MCI improvements at issue here, was the source of the funds "loans and refinancing" secured by the cooperative? If not, then what? The answer to these questions remains unclear.

Nevertheless, DHCR granted the PAR and authorized an MCI rent increase by order issued April 6, 2012. (B-18). As relevant to the dispute here, DHCR noted that the MCI had initially been denied based on the DRA's finding that the claimed improvements "had been paid for with money from a co-op reserve fund, as evidenced by the fact that the checks submitted as payment documentation were imprinted with the account name, '105 West 73rd Owners Corp. Reserve Fund'." To explain why the agency had changed its position, DHCR's Deputy Commissioner simply stated:

> The owner has submitted persuasive evidence on appeal, in the form of a statement from a Certified Public Accountant accompanied by account statements of the co-op corporation, that the initial reserve fund was in fact fully depleted as of the end of 1996, which is prior to the June 23, 2000 onset of the exterior work at issue.

Regarding the effective date for rent controlled apartments, the Commissioner simply stated that "the rent increase is effective as of the first rent payment due after the effective date of this Order," which was issued April 6, 2012.

The owner then filed this Article 78 proceeding challenging the prospective effective date and asserting that the increase should have been made retroactive to November 1, 2006, the month after the DRA had issued its order denying the rent increase. While Ms. Levi has opposed the petition, the tenants have not filed their own

challenge to the recent PAR order granting the MCI increase on appeal, despite their vigorous opposition to the rent increase throughout the ten years that the proceeding was pending.

Discussion

The only regulation addressing the issue here — the effective date of the MCI rent increase for rent-controlled tenants — contains only general language. That regulation, § 2202.2 of the New York City Rent and Eviction Regulations, provides in relevant part that:

> No order increasing or decreasing a maximum rent previously established pursuant to these regulations shall be effective prior to the date on which the order is issued ...

The April 6, 2012 PAR Order challenged here set an effective date of May 1, 2012, the first monthly rent payment date following the issuance of the Order. That effective date is wholly consistent with the language in the Regulation, which effectively bars a retroactive rent increase. The owner contends, however, that because the DRA made a "mistake" in denying the MCI application in the first instance and DHCR in its PAR Order was correcting that "mistake", the effective date should have been calculated using the date the DRA Order was issued, rather than the date the PAR Order was issued, despite the retroactive effect. The difference amounts to approximately $46,000.00, which would be paid as an additional rent increase by the four senior citizen rent-controlled tenants.

In support of its argument, the owner cites three PAR decisions involving MCI applications by Samson Management (Dckt Nos. OA330018RO, OA330028RO, OA330030RO, Exhs I, J and K to Petition). All three decisions were issued on May 31,

2002 and all three appear to involve the same type of improvement, but each relates to a separate building (610, 630 and 650 Victory Blvd. in Staten Island). In all three, the DRA had apparently denied the MCI application on the ground that the improvement, which consisted of balcony and terrace work, had not been completed on a building-wide basis as required by the rent laws. During the administrative appeal, an inspection was conducted, which revealed that although not all apartments had a balcony or terrace, the owner had completed the work on all balconies and terraces that existed. Finding that the work benefitted all tenants by improving the structural integrity of the building, the Commissioner granted the MCI rent increase retroactive to the first rent payment date after the issuance of the DRA order, but without offering any explanation.[2]

This Court rejects the owner's claims here, as the owner has failed to meet its burden of establishing that the agency's decision was arbitrary and capricious or without a rational basis in the record. *Greystone Management Corp. v Conciliation and Appeals Board of the City of New York,* 94 AD2d 614 (1st Dep't 1983), *aff'd* 62 NY2d 763 (1984). As argued by DHCR and the tenant in opposition to the petition here, neither the Commissioner's Order, nor the record as a whole, supports the owner's contention that the Commissioner on appeal was correcting a "mistake" made by Rent Administrator. Quite the contrary, based on the evidence submitted by the owner, the DRA's determination was quite appropriate. As discussed in detail above, that evidence

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[2] The owner in its Petition also cited a PAR Order that set an effective date which took into account an "inordinate delay" in processing by DHCR (Exh L). However, the case is distinguishable in that it deals with rent-stabilized tenants, and not rent-controlled tenants like those here. Also, the party responsible for delay in this case is the owner, not DHCR, as is revealed in the recitation of facts above.

consisted of proof of payment for the MCI work from a checking account entitled "105 West 73rd Owner Corp. Reserve Fund" without any proof that the monies in that account were other than reserve fund monies. The only "proof" submitted by the owner was a conclusory claim by counsel, wholly lacking in evidentiary value, that reserve fund monies had not been used, despite the name of the account.

In light of the regulation explicitly barring an MCI rent increase for work paid for with reserve fund monies, it cannot be said that the DRA made a "mistake," as its conclusion was reasonably based on the evidence demonstrating that all payments had been made from a "Reserve Fund" account. Further, the rule barring MCI increases paid for with reserve funds is clearly stated in the Code and has been accepted by the Court of Appeals in *Versailles Realty Company v DHCR*, 76 NY2d 325, *rearg den.*, 76 NY2d 890 (1990). Contrary to the owner's claim on reply, the DRA had no duty to demand more proof from the owner, and it had full authority to reject the owner's claim due to the incomplete and unpersuasive information provided by counsel in response to the DRA's inquiry about the source of the funds. *See, Maxwell-Kates, Inc. v DHCR,* 194 AD2d 456 (1st Dep't 1993).

While it is true that the Commissioner reversed the DRA Order, that reversal was based on additional evidence submitted by the owner for the first time on appeal. That evidence was submitted in bits and pieces by the owner, as DHCR gave the owner repeated opportunities on appeal to substantiate its claim that no reserve fund monies had been used. Only after the Commissioner was satisfied that the owner had documented its claims did DHCR grant the MCI increase. It cannot be said that the decision to make the rent increase prospective from that date was arbitrary, as the owner had failed to prove its entitlement to the rent increase before that time.

In an attempt to explain why the agency gave the owner a chance to submit evidence of its claims for the first time on appeal — over the tenants' objection — DHCR's counsel cites Rent Stabilization Code § 2527.5, which permits DHCR "at any stage of a proceeding," to accept papers "not filed within the time required by this Code ... for good cause shown." In reply, the owner mocks this assertion as an "after-the-fact rationalization" that has no support in the terms of the DHCR Order, the record as a whole, or the law. The strong language is a veiled attempt to distract from the fact that, but for DHCR's generosity on appeal, the owner's MCI would have been denied in its entirety.

However, the owner's reply arguments must fail. While the Commissioner may not have spelled out his reasoning in the Order, the omission is unfortunately somewhat common practice, and the construction given by DHCR's counsel is not unreasonable. And while it may well be that the law would have supported the agency's rejection of any new evidence offered on appeal when the evidence was available and the issue was raised in the proceedings before the DRA, the tenants have not filed an Article 78 proceeding arguing that point, even though they continue to reiterate that the "owner" has yet to prove who paid for the improvements using precisely what funds. Thus, the Court declines to address in detail the owner's attempted rebuttal of DHCR's arguments related to that point and the "good cause" exception to the rule barring the acceptance of new evidence on appeal.

The administrative decisions cited by the owner do not compel a contrary result. The *Samson* decisions are distinguishable as they dealt with the issue of the completeness of the work, which DHCR ultimately confirmed through its own inspection and not via information sought from the owner. What is more, DHCR has itself cited

administrative decisions which set a prospective effective date consistent with the Order at issue here. In *Matter of Scarselli,* Dckt No. GI430154RO (Nov 5, 1998)(Answer, Exh B), the Commissioner expressly indicated that the rent increase was to be effective prospective only, after the owner had submitted the documentation necessary to prove its claims for the first time on appeal. Similarly, in *Matter of SKJ Realty,* Dckt No. MJ410032RO (March 10, 1999)(Answer, Exh C), the rent increase was granted prospectively only after the owner had completed its application by submitting documentation from the Department of Buildings for the first time on appeal.

Nor is the owner aided by its submission after oral argument. There counsel cited a DHCR Order, *Matter of 923 D Realty, LLC,* Dckt. No. ZJ430010RP (Feb 15, 2013), which granted an MCI rent increase following a reversal and remand from the Appellate Division. The effective date for the rent-controlled tenants was set as the first rent payment date after the issuance of the Administrator's order, which had been reversed. Counsel cites this decision as proof that "DHCR's established practice" is to use the date of the DRA order that was reversed as the basis for the effective date.

However, DHCR correctly distinguishes the case as dealing with the legal issue of what type of elevator upgrading qualifies for an MCI rent increase, whereas the instant case involved a late offer of proof from the owner. In the first instance, a legal determination was reversed, whereas here a new determination was rendered based on new facts. Also, DHCR has submitted yet another decision consistent with the decision herein where the effective date for the rent increase granted on appeal was set prospectively after the owner had submitted all necessary documentation for the first time on appeal. *Matter of R. & A. Mangano,* Dckt. No. SG430079RO (Nov 2, 2006).

In sum, the owner has failed to establish that DHCR's Order was arbitrary and capricious or contrary to established law. While the agency's decision to accept evidence for the first time on appeal was questionable in the eyes of the tenants, that decision did not aggrieve the owner but inured to its benefit. The DRA requested relevant information from the owner in the first instance and had no duty to do more. Under the circumstances here, it was not irrational for the agency to grant the rent increase prospectively only from its receipt on appeal of the documentation necessary to prove that reserve funds had not been used, despite the suggestion by the checks to the contrary.

Accordingly, it is hereby

ADJUDGED that the Article 78 petition is denied and this proceeding is dismissed. The Clerk is directed to enter judgment accordingly.

Counsel for DHCR is directed to pick up the Administrative Return from the Part Clerk in Room 222 at the courthouse at 60 Centre Street.

Dated: July 15, 2013

JUL 15 2013

J.S.C.

ALICE SCHLESINGER