Marion Scott Real Estate, Inc. v New York State Div. of Hous. & Community Renewal
2017 NY Slip Op 32071(U)
September 29, 2017
Supreme Court, New York County
Docket Number: 155807/2016
Judge: Arthur F. Engoron

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 37

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MARION SCOTT REAL ESTATE, INC.,

Petitioner,

RIVERBAY CORPORATION,

Intervenor-Petitioner,

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

-against-

NEW YORK STATE DIVISION OF HOUSING AND COMMUNITY RENEWAL and PRESIDENT MARK COLON,

Respondents.

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Index Number: 155807/2016

Decision and Order

Seq. No. 001

Arthur F. Engoron, Justice

In compliance with CPLR 2219(a), this Court states that the following papers, numbered 1 to 5, were used on Petitioner's, and Intervenor-Petitioner's, separate Verified Petitions, pursuant to CPLR Article 78, to modify Respondents' determination dated June 10, 2016:

	Papers Numbered:
Petitioner's Notice of Petition - Verified Petition - Exhibits	1
Intervenor-Petitioner's Verified Petition - Exhibits	2
Respondents' Verified Answer and Objections	3
Affirmation in Opposition to Verified Petitions - Exhibits (memorandum of law)	4
Petitioner's Affirmation in Further Support of Verified Petition - Exhibits (memorandum of law)	5

Upon the foregoing papers, the Verified Petitions are denied.

Background

In this Article 78 proceeding, Petitioner Marion Scott Real Estate, Inc. ("MSI"), the former managing agent of the Mitchell Lama apartment complex known as Co-Op City, and Intervenor-Petitioner Riverbay Corporation ("Riverbay"), the owner of Co-Op City, ask this Court to modify, in differing ways, the determination dated June 10, 2016 of Respondents New York State Division of Housing and Community Renewal and Mark Colon (collectively, "DHCR") that approved Riverbay's decision not to renew the management agreement between it and MSI

for Co-Op City (the "agreement") and established the agreement's termination date as May 31, 2015. MSI and Riverbay each argue that DHCR's determination is arbitrary and capricious and seek a different (more favorable) termination date. Additionally, Riverbay requests a writ of mandamus compelling DHCR to investigate MSI's alleged fraud and mismanagement of Co-Op City.

DHCR opposes the petitions upon the grounds that they each fail to state a cause of action, and that its June 10, 2016 determination has a rational basis. DHCR opposes the request for a writ of mandamus upon the ground that its authority to investigate MSI is discretionary and cannot be compelled.

A brief statement of the pertinent facts is necessary, and follows. DHCR strictly regulates the management and operation of Mitchell-Lama housing to ensure that rents remain reasonable. DHCR's regulations, specifically, 9 NYCRR 1729-1.2, govern the selection, approval and termination of management agents. As is herein pertinent, under 9 NYCRR 1729-1.2(k), DHCR "may review the performance of a management agent at any time" and, if it determines that, inter alia, the agent is in breach of the agreement or in violation of any law or regulation, DHCR "may terminate" the agreement "pursuant to this Subpart." See 9 NYCRR 1729-1.2(k)(3)(iv).

Further, under 9 NYCRR 1729-1.2(l), an agreement between a managing agent, like MSI, and a housing company, like Riverbay, may be terminated:

> (1) by mutual consent upon 30 days' written notice to the division;
>
> (2) by [DHCR], with cause, such termination to be effective immediately upon notice to the housing company and agent;
>
> (3) by [DHCR], without cause, upon 30 days' written notice to the housing company and agent;
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> * * * * *
>
> (7) by the housing company with cause upon prior approval by [DHCR].

In addition, under 9 NYCRR 1729-1.2(m) a housing company may decide not to renew a management agreement

> . . . upon [the agreement's] expiration on 30 days' notice. However, a housing company may not exercise such notice until it has selected a new managing agent in accordance with the procedures set forth in these regulations and such agent has been approved by the division or the housing company has established to the division that exigent circumstances require a different basis for more immediate selection. Where the managing agent contract

> is not renewed, it will be continued on a month-to-month basis at the existing rate of compensation until a new managing agent is selected.

In 1999, Riverbay and MSI entered into the agreement, which DHCR approved. As required by DHCR's regulations, the agreement provided, in Article 9 thereof, that it could be terminated, inter alia, by DHCR with or without cause (mirroring 9 NYCRR 1729-1.2[l][1], [2], and [3]). In 2012, Riverbay refinanced its mortgage on Co-Op City and the U.S. Department of Housing and Urban Development ("HUD") guaranteed the loan refinance. As a condition to HUD's guarantee, Riverbay extended the agreement with MSI for one-year, through June 30, 2013, at the end of which MSI continued to manage Co-Op City in accordance with the agreement on a month-to-month basis.

Sometime prior to October 2014, Riverbay became aware of MSI's alleged misconduct and fraud in its managerial duties that allegedly resulted in, inter alia, a multi-million dollar class action lawsuit against Riverbay by its employees for violation of United States and New York State Labor Laws, and other damages. In October 2014, DHCR approved Riverbay's proposal to solicit bids for a new managing agent (ostensibly in preparation for Riverbay's non-renewal of the agreement in accordance with the regulations); all bid submissions were due on November 19, 2014. Riverbay received eight timely bids, including one from Douglas Elliman Property Management ("DEPM"). However, on November 17, 2014, without DHCR's approval to do so, Riverbay "excused" MSI from its duties, escorted MSI employees off Co-Op City premises, and locked MSI out of its offices. By letter dated November 18, 2014, DHCR expressed its concern about the "lack of clarity" between Riverbay and MSI on certain issues, but noted that the parties resolved at least one of the complained-of issues. DHCR also reminded Riverbay that any changes to Co-Op City's management, temporary or otherwise, required DHCR and HUD approval and directed Riverbay to "immediately reinstate" MSI. On November 19, 2014, Riverbay issued an Emergency Resolution in which it: (1) enumerated MSI's misconduct and breaches of the agreement; (2) noted that Riverbay is engaged in "a public bidding process for management services" with the approval of DHCR and HUD; (3) requested DHCR to perform an "immediate review" of MSI's performance and to "terminate the expired management agreement"; and (4) advised that its General Counsel would review the issues and "report its findings and recommendations."

What happened over the next eighteen months is largely undisputed and summarized briefly, as follows. After "excusing" MSI from its duties (which Riverbay also characterizes as a "suspension"), Riverbay did not reinstate MSI and instead undertook to self-manage Co-Op City without DHCR's approval. Riverbay continued self-management even though, by May 2015, the eight bids were narrowed to three, including one from DEPM, and all of which Riverbay rejected. On several occasions, DHCR and HUD reminded Riverbay in writing that they did not approve the termination of MSI's agreement, Riverbay's self-management of Co-Op City, or a new managing agent, and that these unapproved actions constituted a breach of the agreement, a default under the loan refinance (guaranteed by HUD), and a violation of 9 NYCRR 1729-1.2. Riverbay, via its General Counsel, also conducted an investigation into MSI's alleged misconduct and fraud, the result of which culminated in its General Counsel's "Report and Recommendations," dated May 26, 2015, a copy of which Riverbay provided to DHCR.

Meanwhile, following its November 17, 2014 "suspension," MSI immediately commenced a breach of contract action against Riverbay in this court (Marion Scott Real Estate, Inc. v. Riverbay Corporation, Index No. 653953/2014) seeking damages in the form of the monthly management fees allegedly due from November 17, 2014 to the date DHCR approved a new managing agent for Co-Op City ("the MSI action"). Riverbay answered MSI's complaint in which it asserts counterclaims – based upon MSI's alleged misconduct and malfeasance – for negligence, breach of contract, contractual indemnification and attorneys fees, for which it seeks damages in the sum of $7,000,000. By Decision and Order dated June 20, 2016, the court (Wooten, J.) granted MSI's motion for partial summary judgment on its breach of contract cause of action and referred the issue of MSI's damages as a result of such breach to a Special Referee to Hear and Determine. As to the measure of MSI's damages, the court found that "[s]ince [MSI] was Riverbay's managing agent on a month-to-month basis, the measure of damages is the duration of its suspension, from November 2014 through the present, or until such time as there is a finding of termination by DHCR."

On June 1, 2016, Riverbay chose DEPM as the new managing agent for Co-Op City; DHCR and HUD approved the choice. On June 10, 2016, DHCR issued its determination in which it denied Riverbay's request that DHCR terminate the agreement for cause under 9 NYCRR 1729-1.2(k) and set the termination date as November 18, 2014, and instead approved Riverbay's decision not to renew its agreement with MSI pursuant to 9 NYCRR 1729-1.2(m) and set the termination date as May 31, 2015. As for "retroactivity," DHCR explained that

> . . . it is important to note that, by November 18, Riverbay had already issued an RFP for a new managing agent and had received responses from several qualified bidders (including DEPM, whom it ultimately selected). As such, before immediately and unilaterally suspending MSI, Riverbay certainly could have begun the process of selecting a managing agent, but chose not to.
>
> Nevertheless, DHCR believes that it is reasonable to establish a date of non-renewal consistent with the time that it should have reasonably taken Riverbay to select a new managing agent. Therefore, the non-renewal of the managing agreement between Riverbay and MSI is made effective as of May 31, 2015.

In a footnote, DHCR further explained its determination, noting that "despite explicit written directives from DHCR" and HUD, "Riverbay chose to lock MSI's employees out of their offices and to self-manage" for fifteen months.

On July 12, 2016, MSI commenced the instant Article 78 proceeding for an order vacating the June 10, 2016 determination as arbitrary and capricious. Upon consent of the parties and by order of this Court, Riverbay intervened herein and filed its own petition for the same relief and for a writ of mandamus compelling DHCR to investigate MSI's alleged misconduct and fraud. DHCR answered and opposed both petitions.

Discussion

DHCR's June 10, 2016 determination approving Riverbay's non-renewal of MSI's agreement

pursuant to 9 NYCRR 1729-1.2(m) and setting the agreement's termination date as May 31, 2015, is based upon a rational and reasonable interpretation of its own regulations. See Gaines v New York State Div. of Hous. & Cmty. Renewal, 90 NY2d 545, 548–49 (1997) ("We have repeatedly held that the interpretation given to a regulation by the agency which promulgated it and is responsible for its administration is entitled to deference if that interpretation is not irrational or unreasonable."). Further (and similarly), DHCR's determination has a rational factual basis in the record. See Matter of Pell v Board of Educ., 34 NY2d 222, 230-1 (1974) (scope of judicial review in Article 78 proceeding limited to whether administrative agency had rational basis for determination); China v New York City Bd. of Standards and Appeals, 97 AD3d 485, 487 (1st Dept 2012) ("the agency's interpretation is entitled to great deference, and must be upheld as long as it is reasonable").

DHCR was not required to investigate MSI and terminate the agreement "for cause" effective November 17, 2014 upon Riverbay's request, or otherwise, as Riverbay urges. The language of 9 NYCRR 1729-1.2(k) is permissive, not mandatory, to wit: DHCR "*may review* the performance of a management agent" upon which it "*may [] terminate[]*" the agreement." See 9 NYCRR 1729-1.2(k)(3)(iv) [emphasis added]. DHCR's construction of the phrase "may review" in 9 NCRR 1729-1.2(k) as one which vests it with the discretion to determine whether or not to investigate an agent is consistent with the discretionary authority to investigate provided to DHCR under the Private Housing Finance Law ("PHFL") § 32(5). Thus, DHCR's interpretation of 9 NYCRR 1729-1.2(k) as providing it with the discretion – as opposed to the mandate – to investigate MSI has a reasonable basis in law and is accepted by this Court. See generally Cohen v Levine, 52 AD2d 997, 998 (1976) ("While construction of specific language in a statute is the function of the courts, where the initial determination by the administrative agency is warranted by the record and has a reasonable basis in law, it is to be accepted."). Consequently, Riverbay is not entitled to a writ of mandamus directing DHCR to conduct an investigation into MSI's conduct, as DHCR's investigation of a managing agent is a discretionary, not mandatory, act. See Klostermann v Cuomo, 61 NY2d 525, 539 (1984) ("What must be distinguished, however, are those acts the exercise of which is discretionary from those acts which are mandatory but are executed through means that are discretionary. For example, the decision to prosecute a suit is a matter left to the public officer's judgment and, therefore, cannot be compelled.").

The record also demonstrates that DHCR had a rational factual basis for its decision not to exercise its discretionary power to investigate MSI and terminate the agreement for cause as of November 17, 2014. See Matter of Pell v Board of Educ., supra; China v New York City Bd. of Standards and Appeals, supra. Riverbay commenced its own independent investigation into MSI, the findings of which it promised to, and did, provide to DHCR. Moreover, Riverbay raised as counterclaims MSI's alleged misconduct in the MSI action, raising the possibility of inconsistent findings by DHCR and the Court on this precise issue.

On this record, absent termination "for cause" by DHCR, the only other basis upon which Riverbay could have ended its agreement with MSI was by non-renewal under 9 NYCRR 1729-1.2(m), and so DHCR found. DHCR's finding on this issue is supported by a rational basis in the record: to wit, non-renewal of the month-to-month agreement would be approved once Riverbay had selected a new managing agent, and Riverbay had selected DEPM as its new

managing agent. See 9 NYCRR 1729-1.2(m) (non-renewal of management agreement requires housing company to select new managing agent).

The record further demonstrates that DHCR's determination setting May 31, 2015 – as opposed to June 1, 2016 – as the agreement's "non-renewal" date, is rationally based. On the one hand, MSI is correct that under a strict application of 9 NYCRR 1729-1.2(m) it would be entitled to management fees through June 1, 2016, the date Riverbay selected DEPM as the new managing agent. See 9 NYCRR 1729-1.2(m) ("Where the managing agent contract is not renewed, it will be continued on a month-to-month basis at the existing rate of compensation until a new managing agent is selected."); Marion Scott Real Estate, Inc. v Rochdale Village, Inc., 23 Misc3d 1129 (Supreme Court Queens County 2009) (month-to-month managing agent entitled to monthly fees through date new managing agent selected).

However, in setting May 31, 2015 as the non-renewal date, DHCR properly took "into consideration all factors bearing upon the equities involved, with due regard for preservation of the subject housing, the rights of the tenants and the public interest." See 9 NYCRR 1700.7; see also 9 NYCRR 1700.5 (requirements of regulation "may be waived if …their application may be shown to effect undue hardship…"). The relevant "factors" on this record are as follows: (1) by the end of May 2015, the list of potential new managing agents for Co-Op City had been narrowed from eight to three, DEPM being one of the three; (2) at a board meeting on May 27, 2015, Riverbay flatly rejected DEPM and the two other agents and instead chose to continue to self-manage Co-Op City, albeit without the approval of DHCR and HUD to do so; (3) one year later, having failed to obtain DHCR and HUD's approval of its self-management, Riverbay selected DEPM as Co-Op City's new managing agent; (4) a non-renewal date of June 1, 2016 would result in an additional $1,000,000 in fees to MSI, above the $600,000 in fees due through May 31, 2015; and (5) the cost of the fees awarded to MSI would be passed along to the innocent shareholder-tenants of Co-Op City by way of increased monthly charges. Thus, in setting May 31, 2015 as the non-renewal date, DHCR properly balanced the equities to "avoid punishing" the shareholder-tenants for Riverbay's failure to follow the regulations and select a new managing agent as quickly as possible – which, on this record, appears to have been May 2015 – and to avoid rewarding MSI for work it did not perform. Moreover, to the extent that MSI's alleged misconduct resulted in damages to Riverbay, those damages can be recovered from MSI in the MSI action, thereby reducing or fully abating the management fees due to MSI through May 31, 2015. Accordingly, DHCR's determination setting May 31, 2015 as the agreement's non-renewal date is based upon a rational basis in the record. See Matter of Pell v Board of Educ., supra; China v New York City Bd. of Standards and Appeals, supra.

The Court has considered the parties' other arguments and finds them to be unavailing or without merit.

Conclusion

The Verified Petitions of Petitioner and Intervenor-Petitioner are hereby denied, and the Clerk is directed to enter judgment dismissing this Article 78 proceeding.

Dated: September 29, 2017

Arthur F. Engoron, J.S.C.