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Housing Part Proceedings: The Tenuous Nature of the Economic-Infeasibility Defense

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HP Proceedings: The Tenuous Nature of the Economic-Infeasibility Defense

By Gerald Lebovits, Esq., and Deborah E. Fisher, Esq.

When an apartment or residential building is in such bad condition that making it safe and habitable would cause a landlord unreasonable economic loss, a judicial order forcing repairs may lead to an unconstitutional taking under the Fifth and Fourteenth Amendments. The economic-infeasibility defense to a request for repairs is a subset of the "takings defense." A landlord may raise this defense, which is grounded in equity, in a Housing Part ("HP") proceeding, itself grounded in equity, brought under Civil Court Act § 110(a)(4), (7).[1]

The defense has met opposition from tenants. Landlords have arguably raised it to evade repairing underinsured apartment buildings and constructively to evict rent-regulated tenants on the basis of profit margins alone. As the case law shows, moreover, most judges are skeptical of the defense. But the defense of economic infeasibility may be successfully asserted in appropriate cases.

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Stipulations: Vacating Settlements and Other Considerations

By Robert Finkelstein, Esq.

When parties to a lawsuit seek to amicably resolve all, or at least some, of the issues in a dispute, they will typically enter into agreements known as "stipulations." Since these contracts are viewed as expedient and efficient dispute resolution mechanisms, a working familiarity with the governing laws and precepts is an absolute imperative.[1]

Parties to a summary proceeding will negotiate the terms of a settlement either in or out of court. While the final document may be drafted and prepared in an attorney's office, the majority are usually handwritten on stipulation forms available in most court houses and are "so-ordered" by the presiding judge or judicial hearing officer. As an alternative, the stipulation may be entered into the record in open court. However, the understanding *must* be recorded in one of these forms in order to be enforceable.[2]

It is of utmost importance that the parties comprehend *(continued on page 10)*

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HP Proceedings Generally

Title 27, Chapter 2, of the New York City Administrative Code ("Housing Maintenance Code" or "HMC") provides for minimum housing standards to be enforced through an HP proceeding in the Housing Part of the New York City Civil Court.[2] The HMC enforces minimum housing standards to "preserve decent housing; to prevent adequate or salvageable housing from deteriorating to a point where it can no longer be reclaimed; and to bring about the basic decencies and minimal standards of healthful living in already deteriorated dwellings, which, although no longer salvageable, must serve as habitation until they can be replaced."[3]

A landlord has a duty to maintain residential premises in a condition fit for human habitation.[4] This duty, enforced through the warranty of habitability, is non-delegable.[5] Although tenants most often raise warranty of habitability as a defense or a counterclaim to a nonpayment proceeding, an HP proceeding allows a tenant to compel repairs affirmatively without having to withhold rent.

Any person who has a lawful right of possession, including licensees[6] and subtenants,[7] may bring an HP proceeding. That right remains even after a warrant issues or until a petitioner surrenders its lease; for rent stabilized or controlled tenants, the right continues until eviction.[8] A squatter has no standing to bring an HP proceeding. Even if a New York City vacate order is in effect, a tenant has standing to bring an HP proceeding while out of possession, and the Civil Court has the jurisdiction to order that the conditions be repaired.[9] A vacate order does not terminate a tenancy.[10]

Constitutional Underpinnings

The Fifth Amendment provides that "private property [shall not] be taken for public use, without just compensation."[11] The Fourteenth Amendment applies the Fifth Amendment's Takings Clause to the states.[12] The Takings Clause prevents the government from forcing individuals to bear burdens that the public as a whole should bear.[13] A law that does not advance legitimate state interests or which denies an owner the economically viable use of land is a regulatory taking.[14] The states, though, have broad powers to regulate housing conditions and landlord-tenant relationships; states need not compensate for all economic injuries that occur from that regulation.[15] The argument underlying the economic-infeasibility defense is that forcing a landlord to repair a building at a loss is an unconstitutional taking under the Fifth and Fourteenth Amendments.[16]

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Background

Although the defense of economic infeasibility is not enumerated in the statutory framework for HP proceedings, case law recognizes that a landlord may interpose it as a defense to an HP proceeding.[17] The defense contemplates that if it would cost more to repair a building than the building would be worth after the repairs, it is the landlord's decision whether to make the repairs.[18]

In *Bernard v. Scharf*,[19] a recent, important case on the subject, cooperative tenant- shareholders brought an HP action to compel the majority shareholder—the building's constructive owner—to restore a fire-damaged building. Housing Judge Peter Wendt found that the majority shareholder did not prove the defense of economic infeasibility and that requiring the building to be restored would not be an unconstitutional taking. The Appellate Term, First Department, affirmed, with a vigorous dissent. The Appellate Division, First Department, later reversed the Appellate Term. In so doing, the Appellate Division unanimously redefined the defense of economic infeasibility. The court changed a seemingly settled body of law to allow the defense even when a landlord underinsures a building in violation of a cooperative offering plan, fails to comply with a vacate order, and decides not to correct Building Code violations caused by a fire.

The Court of Appeals, in turn, declined to affirm or reverse the Appellate Division's holding. Instead, it "reversed" the Appellate Division's "order" and remitted to Civil Court with directions to dismiss the proceeding as moot. By then, the parties' briefs show, the preceding owner went bankrupt and a new owner repaired the building. In dismissing the case as moot, and by citing the cases it did,[20] the Court of Appeals intended that none of the legal analysis below have precedential value.

Given the series of reversals in *Bernard*—and the entirely conflicting reasoning between the Appellate Term and the Appellate Division, which will be examined here—no one can predict how the courts will shape the contours of this important defense. As a result, the economic-infeasibility defense is ripe for further litigation.

In asserting the defense, it is important to remember that "winning" on economic infeasibility does not mean the landlord is off the hook for damages. Economic infeasibility entitles a landlord to demolish a building rather than to repair it. But rent-regulated tenants and possibly free market tenants with leases can still sue in a plenary action for the value of their regulated tenancies, and cooperators can still sue for the value of their shareholdings.[21]

The question then arises whether a landlord should pursue the defense at all, given that the landlord may be liable for damages and demolition costs, which can be expensive. The answer is that the defense gives a landlord autonomy over the fate of its building, allowing it to make a business decision regarding which course of action to take.

Burdens and Elements of Proof

Economic infeasibility is an affirmative defense that a landlord must prove by a preponderance of the credible evidence.[22] The financial components a landlord-respondent should introduce, preferably with expert testimony, to succeed with the defense include:

- ✓ the actual or assessed value of the building;
- ✓ any current offers for the building;
- ✓ the building's tax assessment; and
- ✓ the building's financial operating statement.[23]

The landlord should also put forth evidence of the building's total economic viability.[24]

Valuing a Building

There are two different opinions—each articulated by the courts in *Bernard*—on how to value a building to determine whether it is economically infeasible to order a landlord to make repairs.

The first camp, represented by the Appellate Division in *Bernard,* holds that "the proper method of valuation is to compare the cost of repairing the building to the anticipated market value of the restored structure."[25] According to the Appellate Division, the "relevant issue is the economic condition of the building, not that of the owners."[26] To justify its ruling, the court pointed to the New York City Rent and Eviction Regulations, which provide in the New York Codes Rules and Regulations ("NYCRR") that a landlord may "withdraw damaged housing from the market when 'the cost of removing violations would substantially equal or exceed the assessed valuation of the structure.'"[27] The court also cited to *Housing and Development Administration of the City of N.Y. v. Johan Realty Co.*, in which a landlord was relieved from spending $75,000.00 to restore a building worth only $12,500.00.[28]

The Appellate Division's reasoning in *Bernard* is persuasive but imperfect. The reference to the NYCRR falls short because the regulations do address the question the court faced: how to value a building. The NYCRR simply refers to "assessed valuation," *(continued on page 4)*

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or the city's tax assessment—not the market value. Moreover, in *Johan Realty*, a case on which the Appellate Division relied, the worth of the building was based on its assessment, not its market value after restoration.[29] The bottom line is that the court believed that an owner should not be forced to spend large amounts of money to fix a building that did not warrant the expenditure.[30] And here the court made a business decision that the property was not financially worth repairing—a decision that was ultimately proven wrong: To make a profit the building's next owner repaired the building, a repair that caused the Court of Appeals to dismiss the entire case as moot. From the very history of *Bernard v. Scharf*, one can contend that courts should be reluctant to accept the defense of economic infeasibility, let alone expand it.

In addition, the Appellate Division did not discuss HMC § 27-2002, which favors preserving existing housing stock. The HMC was enacted to "protect and preserve existing housing."[31] Given § 27-2002, the courts have a duty to require landlords to preserve salvageable housing. The issues, then, are what is "salvageable" and what price, under the HMC's public-policy considerations, must an owner pay to assure salvageability. As the Housing Judge in *Bernard* observed, "[t]he court is dealing with strong public policy, as expressed in the statutory and decisional law of New York, requiring owners and landlords to maintain their buildings in safe and habitable condition."[32]

Furthermore,the Appellate Division held that tenants who cannot force repairs have some protection—they can sue for the loss of their tenancies or shareholdings[33]—that right to compensation becomes illusory when, as in *Bernard*, the landlord becomes bankrupt.

It is unlikely that any future court will formulate a test by which economic feasibility is based on a comparison between a building's assessment and the cost to repair it. And at some elusive point, everyone would agree that a blameless landlord's right to economic self-determination outweighs the significant policy considerations that favor preserving housing. The strength of the Appellate Division's test is that it strikes a balance between the cost of repairs and the anticipated market value of the restored building, and in so doing provides a straightforward bright line for future cases.

A second camp gave a far different test to value a building, a test enunciated by Judge Wendt in *Bernard* and affirmed by the Appellate Term. This test compares the cost of repairing a building to the cost of not repairing it. Under this test, to assert the defense successfully, a building owner must prove how much it would cost to:

- ✓ relocate the tenants;
- ✓ demolish the building; and
- ✓ reimburse tenants for losing their proprietary leaseholds or rent-stabilized leases.[34]

It is not enough to show the difference between the cost of restoring the building and the cost of doing nothing: The demolition costs must include the items mentioned above to get a fair picture of the overall costs.[35]

To show economic infeasibility in this alternative test, an owner must also prove that once the building is occupied again it will not generate sufficient income within a reasonable amount of time to recover the extra costs incurred.[36] The court may, however, consider an extreme disparity between the cost of restoration and the building's future value.[37]

Although this alternative formulation is persuasive and upholds the HMC's goals, it is cumbersome. And it does not consider whether an owner can be compelled into a negative investment in a building when an owner did not cause the damage that requires the repairs.

Clean Hands

Disparate views define the clean-hands doctrine for economic infeasibility. According to the Appellate Division in *Bernard*, the doctrine is relevant only if the landlord is at fault for damaging the building.[38] This analysis leaves no shades of grey where those shades will likely appear. For example, a landlord may contribute significantly to a building's poor conditions by failing to cover a damaged area, letting in the elements, and making the damage far worse than it would have been. Where a landlord has contributed to the building's poor conditions, several decisions before *Bernard* have disallowed the defense.[39]

Courts other than the Appellate Division in *Bernard* have found broad applications for the clean-hands doctrine. For example, a court may reject the defense of economic infeasibility when:

- ✓ the economic hardship caused to the landlord is self-inflicted;[40]
- ✓ the landlord "was responsible for the condition of the building";[41] or
- ✓ the owner has violated a statutory obligation or withheld services illegally to force residents to leave.[42]

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An owner who asserts the defense has the burden to prove that the owner cannot be faulted for the conditions that require repair.[43] In addition, the defense may fail if, before it purchased the building, a landlord could have anticipated that repairs would be needed.[44]

In *Eyedent v. Vickers Management*, decided ten years before *Bernard*, the First Department explained that unscrupulous owners should be forbidden from obtaining economic windfalls by allowing their properties to decay beyond rehabilitation.[45] Soon after *Eyedent*, that same court decided *DHPD v. Mill River Realty*,[46] which collaterally estopped an owner from raising economic infeasibility for the first time in a late motion to reargue or renew when the record showed that the owner delayed making repairs required by the existence of outstanding violations. And the Appellate Term in *Bernard* found that a landlord can bring economic hardship on itself, not merely by underinsuring an apartment in breach of an offering plan, but also by knowingly underinsuring a building.[47]

In the same vein is the well-reasoned opinion in *Chan v. 60 Eldridge Corp*.[48]—to which the Appellate Division cited in *Bernard* for a different proposition.[49] In *Chan*, the late Judge Lewis R. Friedman explained that "[t]he low insurance recovery is, simply, irrelevant. Respondent's unilateral decision on the amount of insurance it chose to carry cannot determine the scope of repairs. Any other conclusion encourages underinsurance."[50]

Only the Appellate Division in *Bernard* excused an owner's underinsurance by noting that the shareholders could still sue the (bankrupt) owner for underinsuring in violation of the offering plan.[51]

One could argue that a landlord that underinsured a building in violation of a contractual or statutory obligation ought not be allowed to raise the equitable defense of economic infeasibility, or that a landlord that underinsured a building without breaching a contract or statute ought be permitted to raise that defense. But in *Bernard*, neither the Appellate Term nor the Appellate Division steered that middle course.

It remains to be seen how the courts will apply the clean-hands doctrine in the context of economic infeasibility. The test may center on the landlord's "fault" or "contribution" to deteriorating or destroying a building. Another possibility is that the courts may interpret the clean-hands doctrine as they did before the Appellate Division decided *Bernard*: to hold a landlord responsible for not anticipating insurance needs. Possible, too, is that the courts may stake out a middle ground and ignore an owner's underinsurance unless being underinsured violated a contract or statute.

Marine Rule

The "marine rule" stands for the proposition that if the cost of restoring a building is more than half the structure's value of the building, the building is completely destroyed.[52] The rule does not apply to residential buildings.[53] For that reason the rule may not be used in economic- infeasibility cases in HP proceedings.

Mootness

Even if a building subject to an HP proceeding is demolished, a court may continue to rule on the merits of the proceeding.[54] As the Court of Appeals held—in a holding one takes by inference alone—it is only when a building is repaired that an HP proceeding, and concurrently the defense of economic infeasibility, becomes academic.

7-A Proceedings

The City of New York is subject to an Article 7-A proceeding.[55] Economic infeasibility is a defense, even by the City, to a proceeding to appoint a 7-A administrator.[56] On the other hand, a 7-A administrator may be discharged if a building is not economically viable.[57]

Discovery

With few exceptions, disclosure may be obtained in a summary proceeding only if the court permits disclosure.[58] To obtain discovery, a party must show "ample need."[59] Courts consider six factors to determine whether a party is entitled to discovery:

(1) whether the movant raised facts that support a cause of action or defense;

(2) whether further will information relate to the action or defense;

(3) whether the discovery request is narrowly tailored;

(4) whether any prejudice will result;

(5) if prejudice may arise, whether a limiting order can alleviate it; and

(6) whether the demand can be structured to protect the litigants' rights.[60]

A presumption favors disclosure in some Housing Court proceedings.[61] The economic-infeasibility defense has no established presumption *(continued on page 6)*

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favoring discovery. But a judge will likely grant discovery to a tenant if:

- ✓ the information sought is financial information about the building solely within the landlord's knowledge;[62]
- ✓ the financial information will impact directly on the tenant's case; and
- ✓ obtaining disclosure will clarify disputed facts.[63]

Contempt

Assuming that the Housing Part rejects the economic-infeasibility defense, it will issue injunctions and orders to repair. If the respondent-owner fails to comply, the petitioner may seek to hold the owner in contempt.[64] Contempt proceedings are common enough in HP proceedings that the court provides a form for *pro se* litigants.

There are two types of contempt: civil and criminal. A petitioner, or the court *sua sponte*, may seek criminal contempt if, for example, the respondent willfully disobeys a court's lawful mandate.[65] Proving the willful public wrong inherent in criminal contempt beyond a reasonable doubt makes it relatively rare that a court will punish criminally. Civil contempt, on the other hand, turns on whether a private individual's rights have been harmed, requires a lesser degree of contumacious wilfulness, and focuses on making the aggrieved party whole.[66] Civil contempt requires a showing of "reasonable certainty."[67] A defense to a criminal or civil contempt allegation is that it was impossible to comply with the Housing Part's orders and injunctions. But if a court rejects the defense of economic infeasibility, the accused contemnor may not relitigate the issue at a contempt hearing.[68]

Conclusion

The contours of the defense of economic infeasibility in an HP proceeding has complicated twists and turns, not least among them that the now non-binding opinions in *Bernard v. Scharf* have thrown the defense into confusion and uncertainty. Some in this era of insurance would entirely do away with the defense as unnecessary and as contradicting the principles inherent in maintaining and salvaging housing stock. Others would expand the defense to protect the free market and to assure independent business decision making. At the heart of these contentions lies the age-old conflict between landlords and tenants. Only a ruling from the Court of Appeals will resolve what limits, if any, will be placed on the economic-infeasibility defense. And even then, the issue will be resolved only in a court of law, not in the court of public opinion.

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Endnotes:

1. These provisions enable the Housing Part to enforce the Building Code by issuing injunctions and orders.
2. HMC § 27-2121 (Art. 4, Injunctive Relief).
3. HMC § 27-2002 (1-3).
4. Multiple Dwelling Law ("MDL") § 78; HMC § 27-2005(a), (c); *Park West Mgmt. Co. v. Mitchell*, 47 N.Y.2d 316, 327, 418 N.Y.S.2d 310, 316, *cert denied*, 444 U.S. 9992 (1979).
5. MDL§ 78; HMC § 27-2005(a); *Kandell v. Saunders*, 224 A.D.2d 185, 186, 637 N.Y.S.2d 114, 115 (1st Dep't 1996) (mem.); *Camaj v. E. 52nd Partners*, 215 A.D.2d 150, 151, 626 N.Y.S.2d 110, 111 (1st Dep't 1995) (mem.).
6. *Harrison v. Linus Holding Corp.*, N.Y.L.J., 5/22/96, p. 26, col. 1 (Civ.Ct., N.Y. County).
7. *Various Tenants of 515 E. 12th St., Inc. v. 515 East 12th St., Inc.*, 128 Misc. 2d 235, 238, 489 N.Y.S.2d 830, 833 (Civ.Ct., N.Y. County, 1985).
8. *Shapiro v. Townan Realty Co.*, 162 Misc. 2d 630, 635, 618 N.Y.S.2d 490, 493 (Civ.Ct., N.Y. County, 1994); *In re Muniz*, No. 98-Civ.-6085 (AKH), 1999 WL 182588, at *3 (S.D.N.Y.), *appeal dismissed*, 210 F.2d 432 (2d Cir.1999).
9. *Various Tenants of 515 E. 12th St.*, 128 Misc. 2d at 238, 489 N.Y.S.2d at 833.
10. *Eyedent v. Vickers Mgmt.*, 150 A.D.2d 202, 204, 541 N.Y.S.2d 210, 212 (1st Dep't 1989); *Cirillo v. 2166 Second Ave., Inc.*, 146 Misc. 2d 802, 804, 552 N.Y.S.2d 494, 495 (Civ.Ct., N.Y. County, 1990).
11. U.S. Const. amend. V.
12. *E.g., Chicago, B. & Q.R. Co. v. Chicago*, 166 U.S. 226, 239 (1897).
13. *Armstrong v. United States*, 364 U.S. 40, 49 (1960).
14. *Agins v. Tiburon*, 447 U.S. 255, 260-63 (1980) (discussing takings in context of zoning law).
15. *Pennell v. City of San Jose*, 485 U.S. 1, 12 n.6 (1988).
16. *Bernard v. Scharf*, 246 A.D.2d 171, 176, 675 N.Y.S.2d 64, 67 (1st Dep't 1998), *rev'd as moot*, 93 N.Y.2d 842, 689 N.Y.S.2d 1 (1999) (mem.).
17. *E.g., Bernard*, 246 A.D.2d 171 *passim*, 675 N.Y.S.2d 64 *passim* (1st Dep't, 1998); *Eyedent v. Vickers Mgmt.*, 134 Misc. 2d 481, 483-86, 511 N.Y.S.2d 462, 463-65 (Civ.Ct, N.Y.

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County, 1986), *rev'd & vacated in part on other grounds*, 138 Misc. 2d 459, 528 N.Y.S.2d 270 (App.Term, 1st Dep't 1988) (per curiam), *rev'd on other grounds and restored to Civil Court*, 150 A.D.2d 202, 541 N.Y.S.2d 210 (1st Dep't 1989).

18. *Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 66.

19. *See* 93 N.Y.2d 842, 689 N.Y.S.2d 1 (1999) (mem.), *rev'g as moot* 246 A.D.2d 171, 675 N.Y.S.2d 64 (1st Dep't 1998), *rev'g* 170 Misc. 2d 909, 656 N.Y.S.2d 583 (App.Term, 1st Dep't 1997) (per curiam), *aff'g* 167 Misc. 2d 502, 634 N.Y.S.2d 919 (Civ.Ct., N.Y. County, 1995).

20. *See In re Hearst v. Clyne*, 50 N.Y.2d 707, 718, 431 N.Y.S.2d 400, 409 (1980); *In re Adirondack League Club v. Board of Black River Regulating Dist.*, 301 N.Y. 219, 223, 93 N.E.2d 647, 649 (1950).

21. *Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 67.

22. *Buchanan v. Toa Construction Corp.*, N.Y.L.J., 5/31/89, p. 29, col. 1 (App.Term, 1st Dep't) (per curiam); *Gonzalez v. Navarro*, N.Y.L.J., 8/10/94, p. 25, col. 2 (Civ.Ct., Kings County).

23. *Gonzalez*, N.Y.L.J., 8/10/94, p. 25, col. 2.

24. *Id.*

25.*Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 67.

26. *Id.*, 675 N.Y.S.2d at 66. For this proposition, the court cited *Chan v. 60 Eldridge Corp.*, 129 Misc. 2d 787, 789, 494 N.Y.S.2d 284 (Civ.Ct., N.Y. County, 1985). *Chan*, however, does not say that at all, at page 789 or elsewhere. If anything, *Chan* suggests the opposite, as explained below.

27. *Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 67 (citing 9 NYCRR 2104.9(b), 2204.9(a)(2), and 2524.5(a)(1)(ii)).

28. *Id.* at 176, 675 N.Y.S.2d at 67 (citing *Housing and Development Administration of the City of N.Y. v. Johan Realty Co.*, 93 Misc. 2d 698, 403 N.Y.S.2d 835 (App.Term, 1st Dep't, 1978) (per curiam)).

29. 93 Misc. 2d at 702, 403 N.Y.S.2d at 839.

30. *See Arroyo v. Marlow*, 122 A.D. 821, 823, 505 N.Y.S.2d 892, 894 (2d Dep't 1986) (mem.) (remitting, however, to determine amount of damages for breaching stipulation).

31. *Fernandez v. Tsoumpas Bros. Co.*, 126 Misc. 2d 430, 433, 481 N.Y.S.2d 948, 951 (Civ.Ct., N.Y. County, 1984).

32. *Bernard*, 167 Misc. 2d at 509, 634 N.Y.S.2d at 923.

33. *Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 67.

34. *Bernard*, 167 Misc. 2d at 511, 634 N.Y.S.2d at 924, *rev'd on other grounds*, 246 A.D.2d 171, 675 N.Y.S.2d 64 (1st Dep't 1998), *rev'd as moot*, 93 N.Y.2d 842, 689 N.Y.S.2d 1 (1999) (mem.).

35. *Bernard*, 167 Misc. 2d at 511, 634 N.Y.S.2d at 924.

36. *Id.*.

37. *General Outdoor Advt'g Co., Inc. v. Wilson*, 276 A.D. 63, 66, 93 N.Y.S.2d 131, 134 (3d Dep't 1949) (discussing valuation in commercial context); *Parkchester Alliance v. Parkchester Apts. Co.*, 180 Misc. 2d 548, 552 n.3, 691 N.Y.S.2d 269, 272 n.3 (Civ.Ct., Bronx County, 1999); *Fernandez*, 126 Misc. 2d at 434, 481 N.Y.S.2d at 951-52 (contrasting cost of repairs against value of damaged units).

38. *See Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 66 (citing *Lacks v. City of N.Y.*, 156 Misc. 2d 749, 754, 594 N.Y.S.2d 561, 565 (Sup.Ct., N.Y. County, 1992)).

39. *E.g.*, *Reinbold v. Gottlieb*, N.Y.L.J., 5/31/89, p. 21, col. 2 (App.Term, 1st Dep't) (per curiam); *DHPD v. 69 W. 38th St.*, N.Y.L.J., 8/5/87, p. 11, col. 1 (App.Term, 1st Dep't) (per curiam); *Rodriguez v. Cziment*, N.Y.L.J., 4/22/92, p. 25, col. 5 (Civ.Ct., Kings County).

40. *Cirillo*, 146 Misc. 2d at 804, 552 N.Y.S.2d at 496; *Fernandez*, 126 Misc. 2d at 433, 481 N.Y.S.2d at 951 (ordering repairs of conditions caused by landlord's failure to board up windows and roof of fire-damaged building).

41. *In re Atco-Midwood Assoc. v. Benitez*, 106 A.D.2d 501, 502, 482 N.Y.S.2d 839, 840 (2d Dep't 1984) (mem.), *lv. dismissed*, 65 N.Y.2d 610, 494 N.Y.S.2d 1025 (1985).

42. *DHPD v. St. Thomas Equities Corp.*, 128 Misc. 2d 645, 648, 494 N.Y.S.2d 787, 790 (App.Term, 2d Dep't, 1985).

43. *Lacks*, 156 Misc. 2d at 754, 594 N.Y.S.2d at 565.

44. *Eyedent*, 150 A.D.2d 202, 205, 541 N.Y.S.2d 210, 212-13; *see also Carrasquillo v. Columbia Realty Corp.*, N.Y.L.J., 12/2/92, at p. 25, col. 5 (Civ.Ct., Kings County) (same).

45. *Eyedent*, 150 A.D.2d at 205, 541 N.Y.S.2d at 213.

46. 169 A.D.2d 665, 669, 564 N.Y.S.2d 44, 47 (1st Dep't 1991) (mem.), *dismissed in part as moot & aff'd in part*, 82 N.Y.2d 94, 604 N.Y.S.2d 552 (1993).

47. *Bernard*, 170 Misc. 2d at 916, 656 N.Y.S.2d at 587; *see also*167 Misc. 2d at 512-13, 634 N.Y.S.2d at 924-25 (noting that building was underinsured).

48. *Chan v. 60 Eldridge Corp.*, 129 Misc. 2d 787, 494 N.Y.S.2d 284 (Civ.Ct., N.Y. County, 1985).

49. *Bernard*, 246 A.D.2d at 175, 675 N.Y.S.2d at 67.

50. *Chan*, 129 Misc. 2d at 791, 494 N.Y.S.2d at 287.

51. *Bernard*, 246 A.D.2d at 174, 675 N.Y.S.2d at 67.

52. *Fernandez*, 126 Misc. 2d at 433, 481 N.Y.S.2d at 951.

53. *Id.* at 433-34, 481 N.Y.S.2d at 951; *Bernard*, 167 Misc. 2d at 507-08, 634 N.Y.S.2d at 922.

54. *Eyedent*, 150 A.D.2d at 205, 541 N.Y.S.2d at 213.

55. *Artis v. City of New York*, 133 Misc. 2d 629, 632-35, 509 N.Y.S.2d 734, 737-38 (Civ.Ct., N.Y. County, 1986).

56. *Cirillo*, 146 Misc. 2d at 803, 552 N.Y.S.2d at 495.

57. *E.g.*, McGovern *v. 310 Riverside Corp.*, 49 A.D.2d 949, 949, 374 N.Y.S.2d 137, 138 (2d Dep't 1975) (mem.).

58. CPLR 408.

59. *Hartsdale Realty Co. v. Santos*, 170 A.D.2d 260, 260, 565 N.Y.S.2d 527, 528 (1st Dep't 1991) (mem.).

60. *See, e.g.*, *New York Univ. v. Farkas*, 121 Misc. 2d 643, 647, 468 N.Y.S.2d 808, 811-12 (Civ.Ct., N.Y. County, 1983).

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61. *See, e.g., Cox v. J.D. Realty Assocs.*, 217 A.D.2d 179, 182, 637 N.Y.S.2d 27, 29 (1st Dep't 1995) (nonprimary-residence proceedings).

62. *City of New York v. Cordero*, N.Y.L.J., 4/14/99, p. 29, col. 4 (Civ.Ct., Kings Co.).

63. *Cf. St. George Hotel Assocs. v. Alford*, N.Y.L.J., 9/28/94, p. 24, col. 2 (Civ.Ct., Kings County) (granting disclosure in non-payment proceeding).

64. *See* Judiciary Law § 750 et seq.

65. *Id.* § 750(A)(4).

66. *Id.* § 753.

67. *In re McCormick v. Axelrod*, 59 N.Y.2d 574, 583, 466 N.Y.S.2d 279, 283 (1983) (per curiam).

68. *Leopold v SMJ Mgmt.*, NYLJ, 4/9/97, p. 32, col. 5 (Civ.Ct., Kings County). ◆

REGULATORY UPDATE

Taxation: IRS Issues Final Rules on Tenant Construction Allowances

It's common for commercial landlords to provide tenants with construction allowances for the purpose of improving the premises. For instance, a landlord might give a new tenant the funds it needs to construct its space, or provide a current tenant with a rent abatement to pay for a remodeling project. Thanks to the Tax Reform Act of 1997, "retail" tenants are not required to pay income tax on the value of these giveaways. A construction allowance may be excluded from gross income, so long as it's used for construction or improvements to the space that revert to the landlord at the end of the lease.[1] However, new regulations issued by the IRS on September 5, 2000 create a few new hoops for tenants to jump through to qualify for the exclusion.[2]

Qualifying Tenants

To be eligible for the exclusion, the tenant must rent "retail space" under a "short-term lease."[3]

What's "retail space?" The space must be leased, occupied or used in the trade or business of selling tangible personal property or services. The new regulations clarify that offices for attorneys, doctors, accountants, insurance agents, financial advisors, stock brokers, securities dealers (including dealers who sell securities out of inventory), bankers, hair stylists, tailors, shoe repairers are included. The term "retail space" isn't limited to the space where retail sales are made. It also includes space where activities supporting the retail activity are performed such as back office areas, administrative offices, storage areas, and employee lounges.

What's a "short-term" lease? The regulations define a short-term lease as a lease (or other agreement for occupancy or use) of retail space for 15 years or less. Any option to renew at fair market value, determined at the time of renewal, is not taken into account for purposes of determining the lease term.[4]

Special Lease Provision Required

One new requirement created by the regulations is for the tenant's lease agreement to expressly provide that "the construction allowance is for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at the retail space."[5] An ancillary construction allowance agreement between the landlord, executed contemporaneously with the lease or during the term of the lease, will satisfy this requirement, according to the regulations.

Time Limit on Expenditures

Another new requirement is that the tenant promptly expend the construction allowance within eight and one-half months after the close of taxable year in which it is received by the tenant.[6] Tracing of the construction allowance to the actual tenant expenditures for the construction or improvement is not required. However, the tenant should maintain accurate records of the amount of the construction allowance received and the expenditures made.

Reporting Requirement

Finally, construction allowance information must now be furnished to the IRS. This is accomplished by attaching a statement of required information to the landlord or the tenant's Federal income tax return for the taxable year in which the construction allowance was paid by the landlord or received by the tenant.[7] Failure to furnish the required information may subject the parties to penalties.