GDB LAW

Fall 2019

LEGAL UPDATE

Providing current information about legal developments for our clients and friends.

The below articles both discuss the new tenant protection legislation, known as The Housing Stability and Tenant Protection Act of 2019, *which significantly alters New York's rent laws and impacts the City's numerous cooperatives and condominiums. These two articles address a few of the specific issues that are creating unintended consequences for many cooperatives and condominiums, such as the new provisions regarding security deposits and financial and operating procedures.*

Security Deposits Limited to One Month — What's a Landlord to Do?

By: Scott M. Smiler, Esq.

As previously discussed in our last newsletter, and in another article in this newsletter, Governor Cuomo recently signed into law *The Housing Stability and Tenant Protection Act of 2019,* more commonly known as the New Rent Law, which drastically altered the landlord-tenant landscape and made sweeping changes to the practice of real estate law.

One of the changes regards security deposits. Prior to the enactment of the New Rent Law, landlords in non-rent regulated residential units were free to set the amount of their tenant's security deposit as they saw fit — traditionally, between one to three month's rent. This has changed as the New Rent Law now mandates that no tenant deposit or advance shall exceed one month's rent.

The entire amount of the tenant's deposit or advance shall be refundable to the tenant within fourteen days of the tenant vacating the demised premises except for an amount lawfully retained by the landlord for the reasonable and itemized costs due to tenant's non-payment of rent, damage caused by the tenant beyond normal wear and tear, non-payment of utility charges payable directly to the landlord under the terms of the lease or tenancy, and moving and storage of the tenant's belongings. Within such fourteen day period, the landlord shall also provide the tenant with an itemized statement indicating the basis for the amount of the deposit or advance retained.

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How to Comply with Part M of *The Housing Stability and Tenant Protection Act of 2019*

By: Marc J. Luxemburg, Esq.

Part M of the New Rent Law contains a number of other provisions that create financial and operating difficulties for all cooperatives and, to some extent, condominiums. Part M was passed without any public input and apparently without any recognition on the part of any of the legislators that it would affect cooperatives. The law specifically affects admissions and operating procedures and adversely affects litigation brought by a cooperative. In this article we deal with the admissions and operating issues — litigation will be dealt with more specifically in a future issue.

A. Admissions Issues

- ***Section 10*** of the New Rent Law prohibits a landlord or grantor from charging a fee for the processing of an application, or any charge before the beginning of any tenancy, except a limited fee for a background check. Whether this applies to the customary fees charged by the managing agent, or to move-in fees or elevator use fees, is an open question.
- We note the New York State Department of State recently issued guidance that the limit on application fees does

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IN THIS ISSUE

Commercial Bribery on a Construction Site: Does Crime Pay?

By: Randy J. Heller, Esq.

Can you plead guilty to falsifying business records in a commercial bribery scheme involving construction work and still hope to salvage your claim for millions of dollars against the owner you ripped off? You might, under the right set of facts.

Adelhardt Construction Corp. ("ACC") had a long-time relationship with Citibank, having done work for the bank, without incident, for approximately 60 years. In 2012, however, Citibank hired one John Cassisi who proceeded to "systematically" withhold payment from ACC for services which had already been performed and invoiced. He demanded that ACC perform work on his personal residence before ACC would be paid. ACC did not report Cassisi to Citibank or to the authorities.

Cassisi was eventually caught and, in 2015, he pleaded guilty to commercial bribery and went to prison. ACC and its CEO pleaded guilty to falsifying business records (creating fake purchase orders) and agreed to make restitution to Citibank in the sum of $442,000, which the DA allowed to be deducted from amounts otherwise due to ACC for past work. But what about the other $4+ million dollars ACC was owed by Citibank? Would ACC have to forfeit that as well?

> *"No court should be required to serve as paymaster of the wages of crime."*

Citibank refused to pay, arguing that ACC's criminal conduct disentitled it to any further payment. They relied on a seminal case from 1960 holding that "a party to an illegal contract cannot ask a court of law to help…carry out [an] illegal object." That court went on: "No court should be required to serve as paymaster of the wages of crime."

But ACC argued that there was no direct connection between the illegal transaction and the obligation sued upon. It argued that Citibank was using the illegality defense not as a shield for the public good, but rather as a sword for its personal gain. ACC argued that it was "extorted" and should not have been expected to call the police on its 60-year client — particularly at a time it was owed millions of dollars.

Ultimately, the court held that Citibank failed to establish that ACC's conduct was "gravely immoral" so as to completely bar damages. ACC did not bribe anyone to procure the contracts in the first place. It worked with Citibank long before Cassisi came on the scene. And Citibank could scarcely claim the high moral ground when it was its own employee (Cassisi) who was wrapped up in it all.

In the end, Citibank's motion to dismiss the ACC action was denied, and ACC was permitted to pursue its $4+ million contract balance — after making appropriate restitution. Some might say it got off lucky.

Ideally, you will never have to cite this case as precedent in your own lawsuit.

ABOUT THE AUTHOR

Randy J. Heller *is a partner at Gallet Dreyer & Berkey, LLP. He represents contractors and owners in a wide array of sophisticated construction related matters as well as litigation. In addition to being named a Super Lawyer for many years running, Mr. Heller was named by* U.S. News & World Report's Best Lawyers® *as 2020 "Lawyer of the Year" for excellence in Construction Litigation. These lawyers are selected based on the impressive voting averages received during the peer review assessments. In addition, Mr. Heller and Gallet Dreyer & Berkey, LLP have also received the highest "Tier 1" rating by* U.S. News & World Report *for its construction law and litigation practice. Mr. Heller can be reached at rjh@gdblaw.com.*

New York's SHIELD Act Clarifies Data Security Obligations

By: Kyle G. Kunst, Esq.

On July 25, Governor Cuomo signed the "Stop Hacks and Improve Electronic Data Security Act," (SHIELD Act), into law. The SHIELD Act amends existing New York law to clarify the steps a business must take when it suffers from a data breach. The SHIELD Act also created a brand new law, General Obligations Law "GOL" § 899-bb, that describes the security protocol that must be put in place to protect the "private information" of a New York resident.

"Private information" is defined as social security numbers, driver's license numbers, financial information such as account numbers or passwords, biometric information including fingerprints, voice prints, retinal images or "digital representation of biometric data that are used to authenticate or ascertain the individual's identity," or information which may be used to access an email account.

Two Paths to Data Security Compliance

GOL § 899-bb creates two paths to data security compliance. First, any person or business is compliant under the SHIELD Act if it is also subject to and in compliance with the Gramm-Leach-Bliley Act, the Health Insurance Portability and Accountability Act of 1996, or any data security rules or regulations of New York or the federal government.

> *Companies that purchase or possess private information of New York residents should alert their internal information technology professionals or their outside vendors to the SHIELD Act to ensure compliance.*

The second path to SHIELD Act compliance is implementation of the data security protocols listed in GOL § 899-bb. Some of those protocols include designating one or more employees to coordinate the security program, training and managing employees in the security program practices and procedures, regularly testing and monitoring the effectiveness of key controls, systems and procedures and detecting, preventing and responding to intrusions.

However, the SHIELD Act carves out an exception for a "small business," which is any business "with (i) fewer than fifty employees; (ii) less than three million dollars in gross annual revenue in each of the last three fiscal years; or (iii) less than five million dollars in year-end total assets, calculated in accordance with generally accepted accounting principles." A small business is compliant if it implements a data security program which is reasonable for the nature and scope of that business and the sensitivity of the personal information that business collects.

Violation of the SHIELD Act's data security requirements subject the non-compliant person or entity to civil penalties. Though the SHIELD Act expressly disclaims any right to private action under that statute, courts applying New York law have permitted private actions against companies for data breaches based upon other legal theories.

Companies that purchase or possess private information of New York residents should alert their internal information technology professionals or their outside vendors to the SHIELD Act to ensure compliance.

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Kyle G. Kunst *is an associate at Gallet Dreyer & Berkey, LLP. He has litigated commercial disputes throughout the nation in both state and federal courts, servicing a wide array of industries and clients. Mr. Kunst can be reached at kgk@gdblaw.com.*

OUR PRACTICE AREAS INCLUDE:

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- *Mergers and Acquisitions*
- *Real Estate Law*
- *Tax Law*
- *Trusts and Estates*

How to Comply with Part M

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not apply to cooperative purchase/sale transactions. It remains to be seen if the courts will accept this view.

- There is a reasonable argument that if processing fees are charged by the managing agent for its own account and not for the cooperative, it would not be covered by the statute.
- Elevator use fees, or move-in move-out fees, should not be charged until after the purchaser acquires title to the apartment.

■ ***Section 5*** prohibits a landlord from refusing to offer a lease to a potential tenant because the tenant was involved in any prior landlord-tenant proceedings (but not other proceedings). A (rebuttable) presumption is created that a refusal is in violation of this section if the cooperative inspected housing court records relating to the potential tenant.

- This will make it more difficult for boards to refuse to approve a prospective shareholder based upon a background check on prospective purchasers. Boards can still do litigation searches on cases that are not in the housing court, and should be careful to limit the search sources to general litigation.

B. Operational Issues

■ ***Section 9 (d)*** of the New Rent Law provides that if the shareholder fails to pay rent within 5 days of the due date, the coop or managing agent (not the attorney) must give notice by certified mail, and the failure to give such a notice is a defense in an eviction proceeding based on non-payment of rent.

- Attorneys can prepare these notices but they must be signed by the coop or managing agent.
- It is not clear whether rent for purposes of this section includes assessments, or other charges defined in the lease as "additional rent." We note that Section 11 of the new law dealing with legal proceedings defines "rent" as the monthly amount charged for occupancy of the apartment. While this by its terms is limited to a legal proceeding, courts may apply it to section 9 as well.
- Accordingly, it might be prudent to either (i) send two notices, one for unpaid rent and one for unpaid assessments and other non-rent items or (ii) rename what are now assessments as an increase in the monthly rent, and charge only one amount.

■ ***Paragraph 2 of Section 10*** prohibits the imposition of any fee or charge for the late payment of rent that exceeds $50, or 5% of the rent, whichever is less.

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This certainly applies to late fees and applies regardless of the proprietary lease or house rules' provisions imposing late fees. Note, if a cooperative obtains a judgment against a delinquent tenant who fails to pay rent timely, the law provides for the payment of prejudgment interest. Query whether the new law will affect the cooperative's rights to collect prejudgment interest.

- This section can only serve to induce shareholders not to pay maintenance, since not paying the co-op is cheaper than borrowing from a bank.

■ ***Section 3*** requires a landlord (including a shareholder or unit owner who is subletting) to give written notice of an intent to raise the rent (maintenance), upon a renewal of a tenancy, by more than 5%, or an intent not to renew the lease. Virtually all subleases are for a limited term of one or two years. If the notice is not given, the tenancy continues until a notice is given. This may make it impossible to evict a one or two year subtenant unless the unit owner gives such a notice.

- The board may require that a notice not to renew be incorporated into the lease at inception, or may require that the subletting owner give the board a power of attorney to send a non-renewal notice.

> *It seems evident that in the rush to benefit rental tenants, cooperatives and condominiums were simply ignored in the legislative process. There is an opportunity to push back against the application of Part M to cooperatives and condominiums and we hope that every board will take this opportunity to get involved in the process and make their voices heard.*

■ ***Section 9*** requires a cooperative to give a written receipt for any payment of rent in any form other than by check, signed by the person receiving the payment, within fifteen days of receipt. This applies to any other form of payment, including electronic payments by preauthorized withdrawals, or payments by credit card.

- This will require the co-op to create an automatic system for the generation of a receipt, and for any but the smallest buildings, a form of electronic signature on the receipt.

As noted above, it seems evident that in the rush to benefit rental tenants, cooperatives and condominiums were simply ignored in the legislative process. There is an opportunity to push back against the application of Part M to cooperatives and condominiums and we hope that every board will take this opportunity to get involved in the process and make their voices heard. We strongly recommend to all our clients that they communicate in person with both their assembly person and their state senator and advocate that the law be amended so that Part M does not apply to cooperatives and condominiums.

Please do not hesitate to call us if you have any questions about how to comply with these new requirements.

ABOUT THE AUTHOR

Marc J. Luxemburg *is a partner at Gallet Dreyer & Berkey, LLP. His practice focuses on real estate transactions, cooperative and condominium law, and real estate litigation. Mr. Luxemburg represents numerous buildings and sponsors in the New York City area. He is the President of the Council of New York Cooperatives and Condominiums, a non-profit membership organization with more than 2,300 cooperative and condominium members, which provides educational activities and monitors legislation that affect its members. He has taught numerous seminars on the legal aspects of operating cooperatives and on the role of the board of directors. Mr. Luxemburg can be reached at mjl@gdblaw.com.*

Security Deposits Limited to One Month

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The New Rent Law also imposes a pre- and post-occupancy inspection period.

Any party who violates these provisions shall be liable for actual damages, and a person found to have willfully violated them shall be liable for punitive damages of up to twice the amount of the deposit or advance.

Law's Effect on Cooperatives

Cooperative boards are given the task and authority under its governing documents to approve potential purchasers. Some purchasers do not have strong enough financials to garner board approval, but in lieu of an outright rejection of the purchaser, cooperative boards quite often grant a conditional approval which, among other things, requires the purchaser to place a certain amount of money in escrow for a defined period of time. The amount of the escrow is usually equal to 6 to 24 months of the unit's monthly maintenance, and the escrow is returned to the purchaser (now a shareholder) so long as he/she is not in default of his/her financial obligations to the cooperative for a period of time, usually equal to 6 to 24 months. Each maintenance escrow agreement is case specific. However, if the escrow amount is greater than one month's maintenance, the cooperative would run afoul of the New Rent Law.

Some purchasers do not have strong enough financials to garner board approval, but in lieu of an outright rejection of the purchaser, cooperative boards quite often grant a conditional approval which, among other things, requires the purchaser to place a certain amount of money in escrow for a defined period of time.

What's a Landlord, or Cooperative To Do?

1. Reject the tenant (or in the case of a cooperative, reject the purchaser).

2. Take a security deposit from the tenant (or in the case of a cooperative, a maintenance escrow from the purchaser) in an amount equal to one month's rent (or in the case of a cooperative, an amount equal to one month's maintenance).

3. In addition to or in lieu of Option #2, have an individual or entity personally guaranty the rental payments (or in the case of a cooperative, the maintenance payments).

4. In addition to or in lieu of Option #2, have an individual or entity personally guaranty the rental payments (or in the case of a cooperative, the maintenance payments) AND have the guarantor deposit with the landlord (or the cooperative, as the case may be) a certain dollar amount to securitize the guarantor's obligations. Since these funds are not deposited or advanced by the tenant, but rather, the guarantor, we believe that this arrangement is permitted under the New Rent Law.

5. In addition to or in lieu of Option #2, there are third-party companies that will guaranty the tenant's rental payments under a traditional lease. (We have not seen this in connection with the guaranty of a proprietary lease). However, in the event the tenant (as opposed to the landlord) pays the third-party company's fees, then the aggregate amount of the fees should not exceed an amount equal to one month's rent; otherwise, there is a risk of violating the New Rent Law. It is also advised that a landlord not take a security deposit equal to one month's rent AND have the tenant pay the third-party company's fees – this arrangement would aggregate to an amount greater than a deposit or advance equal to one month's rent and would violate the New Rent Law.

For both traditional landlords and cooperatives, the law makes it more difficult to operate and emphasizes the necessity for a well-drafted personal guaranty.

ABOUT THE AUTHOR

Scott M. Smiler *is a partner at Gallet Dreyer & Berkey, LLP. His practice focuses on real estate law, cooperative and condominium law, and corporate law. He represents buyers and sellers of commercial and residential properties, commercial and residential landlords and tenants, and corporate and private borrowers in connection with purchases, refinances and construction loans. Mr. Smiler is also involved in representing cooperative and condominium boards on matters ranging from minor quality of life issues to major capital improvement projects. Mr. Smiler can be reached at sms@gdblaw.com.*

FIRM NEWS AND HONORS

Marc J. Luxemburg

In June, partner Marc J. Luxemburg presented a two-part seminar for new directors titled "An Introduction to Co-op Board Responsibilities" with co-presenter Gregory Carlson, President of the National Association of Housing Cooperatives.

In October, Mr. Luxemburg presented a seminar on the new form of Proprietary Lease and the changes it makes from current forms in use, with a new emphasis on the changes that may be required to comply with Part M of *The Housing Stability and Tenant Protection Act of 2019.*

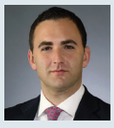
Randy J. Heller

In August, *U.S. News & World Report's Best Lawyers®* named partner Randy J. Heller as the 2020 "Lawyer of the Year" for excellence in Construction Litigation. These lawyers are selected based on the impressive voting averages received during the peer review assessments.

Michelle P. Quinn

In August, partner Michelle P. Quinn authored an article that was published in *Habitat Magazine* titled "Committees Can Lighten a Board's Work Load — If They're Run Right."

David I. Faust and Adam J. Berkey



In August, partner David I. Faust with the assistance of associate Adam J. Berkey authored two chapters soon to be published in *Trusts in Prime Jurisdictions 5th Edition,* one titled "The Trustee as Fiduciary/Some Practical Considerations" and the second titled "International Trust Litigation Jurisdiction and Enforcement."

Jay L. Hack

In August, partner Jay L. Hack's article "Proof of Insurance: Be Careful What You Ask For – You don't Always Get What You Want" was published in the Summer 2019 issue of the *NY Business Law Journal.*

In September, Mr. Hack was the featured speaker in a presentation of the New York Association of Realty Managers on the effect on mortgage lending of the amendments to the New York rent laws.

Also, Mr. Hack was quoted in the online newsletter of the Association of Certified Anti-Money Laundering Specialists article on the General Accounting Office Criticism of FinCEN for not adequately sharing data on bank reporting of potential criminal activity.

David L. Berkey

In September, partner David L. Berkey was a panelist discussing pre-contract due diligence at a CLE program given by the New York City Bar Association entitled "Residential Real Estate Closings: What You Need to Know From Pre-Contract to Closing."

Marc J. Luxemburg and Peter R. Massa

In October, partner Marc J. Luxemburg and partner Peter R. Massa gave a presentation organized by the New York Council of Cooperatives and Condominiums on the impact of *The Housing Stability and Tenant Protection Act of 2019* on Co-ops and Condos, with an emphasis on admissions and operational issues.

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