APL-2020-00127

To be argued by:
DIANA LAWLESS
15 minutes requested

Court of Appeals
State of New York

In the Matter of

ROBINSON CALLEN as Trustee of CASPER R. CALLEN TRUST c/o SALON REALTY CORPORATION,

Petitioner-Respondent,

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

against

NEW YORK CITY LOFT BOARD,

Respondent-Appellant,

(caption continued on inside cover)

BRIEF FOR APPELLANT

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January 8, 2021

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and

RICHARD FISCINA, LUKE WEINSTOCK, ZENIA DE LA CRUZ, AND MARIA THERESA TOTENGCO,

Respondents-Respondents.

In the Matter of the Application of

RICHARD FISCINA,

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

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and

ROBINSON CALLEN AS TRUSTEE OF CASPER R CALLEN TRUST, LUKE WEINSTOCK, ZENIA DE LA CRUZ, and MARIA THERESA TOTENGCO,

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PRELIMINARY STATEMENT

The State's Loft Law creates a statutory process in New York City, supervised from start to finish by the City's Loft Board, governing legalization of commercial buildings for safe residential use. It has the unique feature of allowing incumbent tenants to remain living in a building without a residential certificate of occupancy during the process of legalization. While the law's execution over the decades has not been perfect, it's been a key form of affordable housing in the city—and it remains so.

Here, after the tenants invoked the Loft Board's jurisdiction by applying for Loft Law coverage, the owner struck an agreement with them to continue illegal use of the building outside of the Loft Law framework. The Board (a) rejected the agreement as against public policy, and (b) likewise rejected the tenants' associated attempt to withdraw their application for Loft Law coverage. On article 78 review, the First Department correctly confirmed the Board's decision to reject the agreement, but nonetheless annulled as irrational its rejection of the attempt to withdraw.

The Court should reverse the latter ruling. Having rationally rejected the underlying agreement, the Board also rationally rejected the tenants' attempt to withdraw their application and directed further investigation into Loft Law coverage. After all, the tenants' attempt to withdraw their coverage application went hand in hand with the illegal agreement, whose terms expressly required them to withdraw the application with prejudice. The First Department had no basis to separate the two.

More fundamentally, the Board acted rationally where it knew the direct result of allowing withdrawal would be continued residential occupancy outside the Loft Law, with no residential certificate of occupancy—something that's plainly illegal. Once an illegal residential occupancy of a commercial building comes to the Board's attention, it is not required to sanction the continuation of that arrangement in deference to tenants who have been induced by their landlord to drop their coverage application. To hold otherwise would denigrate the Legislature's judgments in enacting the Loft Law, as well as the Board's delegated authority to implement those judgments.

QUESTION PRESENTED

Having filed an application asking the Loft Board to find that their units are covered by the Loft Law, the residential occupants of a commercial building later reached an agreement with the owner to withdraw that application and perpetuate an illegal living arrangement outside of the Loft Law framework. After finding that the Loft Board rationally rejected the settlement agreement as a violation of public policy, did the Appellate Division wrongly require the Loft Board to accept the withdrawal of the application—and thus to effectively endorse the illegal residential occupancy?

STATEMENT OF THE CASE

A. How the Loft Law protects residential tenants who live in buildings approved only for commercial use

1. The Legislature's enactment of the Loft Law to make commercial buildings safe for residential occupancy

In New York City, it is illegal to live in a building that lacks a residential certificate of occupancy. Multiple Dwelling Law (MDL) §§ 301, 302(1). A residential certificate of occupancy signifies that a building's residential portions satisfy all laws

governing residential use, including fire and safety standards. *Id.* § 301. As this Court has explained, residential occupancy absent a residential certificate of occupancy is "illegal pure and simple: The tenants ha[ve] no right to be there, and the landlords ha[ve] no right to collect rent." *Chazon, LLC v. Maugenest*, 19 N.Y.3d 410, 413 (2012).

In the 1980s, however, a glut of manufacturing space and a shortage of affordable housing led landlords and tenants to ignore the certificate-of-occupancy requirement. After manufacturers abandoned their facilities—some well over a century old—building owners started to rent the spaces to willing residential tenants. *165 W. 26th St. Assocs. v. Folke*, 131 Misc. 2d 867, 871 (Sup. Ct. N.Y. Cnty. 1986). Many were artists and craftsmen drawn to the large, open former manufacturing spaces—known as "lofts"—as places to both live and work. *Id.; see generally* Bill Jacket, L. 1982, ch. 349. But gentrification left those first tenants facing eviction, as owners found other people willing to pay higher rents. *Folke*, 131 Misc. 2d at 871; *see generally* Bill Jacket, L. 1982, ch. 349.

Regardless of who lived in the converted buildings, the conversions created a "serious public emergency." Landlords were converting commercial and manufacturing loft buildings to residential use in violation of applicable building codes and local laws regarding minimum housing maintenance standards. MDL § 280. The absence of those minimum standards created very real dangers.

Owners tended to maintain the buildings without basic safety features, like sprinkler systems, windows in all units, and multiple means of egress. *See* Ltr. from Mayor Edward I. Koch, Bill Jacket, L. 1982, ch. 349; *see also* MDL § 277. During a fire or other emergency, their absence could prove fatal both to those already inside and to first responders, who would be rushing into the building unaware of its non-compliance with basic fire-safety measures. Moreover, the tenants had often engaged in do-it-yourself construction, plumbing, electrical, and gas work to convert "raw" space into a home. *See, e.g., Bishar v. Dukas*, 129 Misc. 2d 652, 654 (Civ. Ct. N.Y. Cnty. 1985); Ltr. from Thea Halo, Bill Jacket, L. 1982, ch. 349. That shoddy and unregulated

workmanship endangered residents, visitors, first responders, passers-by, and the local public utility grid.

The Legislature responded by enacting the Loft Law, codified at MDL article 7-C, §§ 280–87, "as a means of bringing [these residences] within the law." *Chazon*, 19 N.Y.3d at 413. At its core, the Loft Law created a statutory process for converting commercial buildings already occupied by residential tenants into buildings that are safe and legal for residential occupancy. The law requires the owners of such buildings "to alter them to conform to safety and fire protection standards, ultimately doing everything necessary to obtain a residential certificate of occupancy." *Id.* at 414; *see* MDL § 284(1).

Given that the Loft Law covers non-residential buildings that are already occupied by residential tenants, a key part of the statute addresses interim arrangements while legalization is in progress. It provides that an owner's compliance with the Loft Law's legalization benchmarks permits occupants to continue residing in the building despite its lack of a residential certificate of occupancy—a condition that is otherwise illegal under MDL

§ 301. *Id.* § 283; *Chazon*, 19 N.Y.3d at 414. And, again assuming compliance, landlords may collect rent for those residential units while the legalization process is underway. MDL § 285; *Chazon*, 19 N.Y.3d at 414. By creating an exception to the MDL's certificate-of-occupancy mandate to allow occupants to remain in their units during the legalization process, the Legislature sought to "prevent uncertainty, hardship, and dislocation" while also "protecting the public health, safety, and general welfare." MDL § 280; *see generally* Bill Jacket, L. 1982, ch. 349.

Under the Loft Law, legalization mostly entails extensive construction work. The owner first files an alteration application with the City's Department of Buildings (DOB). MDL § 284(1). After obtaining a permit, the owner usually has 18 months to comply with MDL article 7-b's fire and safety standards, such as installing a sprinkler system, fireproof doors, and other fireproof material. *Id.* §§ 277, 284(1). Within another 18 months (or less, under recent amendments), the building should meet all the

requirements for a residential certificate of occupancy. *Id.* § 284; 29 RCNY § 2-01.[1]

The Legislature also created the Loft Board—consisting of mayoral appointees representing the public, the real estate industry, tenants, and commercial and manufacturing interests—to execute the law and administer the legalization process from beginning to end. MDL § 282. The Legislature gave the Board broad and varied duties: determining which buildings, units, and tenants are entitled to the law's protection; addressing claims of hardship from owners; setting and resolving disputes about rates of rent during the interim legalization period; and issuing and enforcing rules about housing maintenance standards, rates of rent, and resolution of disputes. MDL § 282(1). The Board's wide discretion also includes authority to extend the statutory deadlines for completing legalization work. *Id.* § 284(1)(viii); 29 RCNY § 2-01(b).

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[1] The applicable dates for the various milestones are available at: https://www1.nyc.gov/assets/loftboard/downloads/pdf/cctimetable.pdf (last visited Jan. 7, 2021).

At the beginning of the legalization process, the tenants' rent remains the same as in any operative lease with the landlord or, absent a lease, the same as the rent most recently accepted by the landlord. MDL § 286(2)(i). As an incentive to bring the units into code compliance, the Loft Law permits owners who undertake legalization process to increase the rent after they meet specific milestones: filing an alteration application; obtaining a permit; and achieving fire and safety compliance. *Id.* The Board administers these increases through its own rent guidelines. 29 RCNY §§ 2-06, 2-06.1.

Upon confirming that the building's residential portions comply with the MDL, the building code and rules, and all other applicable laws, DOB issues a residential certificate of occupancy. MDL § 301(1). Once the owner obtains the new certificate of occupancy, the Board sets the initial rent for rent stabilization. *Id.* § 286(3). The building then becomes a rent-stabilized Class A multiple dwelling, regulated by the New York State Division of Housing and Community Renewal (DHCR) and no longer subject to the Board's jurisdiction. *Id.*

In 2012, this Court deemed the Loft Law "less than a complete success." *Chazon*, 19 N.Y.3d at 414. Nonetheless, the Loft Law remains the Legislature's chosen and reaffirmed method of converting illegally occupied commercial buildings into legally occupied residential buildings. The Legislature has renewed the Loft Law multiple times over the years, most recently in 2019, after this case was brought. L. 2019, ch. 41.

2. Applications for Loft Law coverage and the Loft Board's coverage determinations

The Loft Law protects only a limited class of buildings or residential portions of buildings. In the law's parlance, these are known as "*interim* multiple dwellings," confirming the statute's focus on regulating residential occupancy during the transitional period represented by the legalization process. MDL § 281.

To qualify as an interim multiple dwelling, a building or part of one must meet three basic criteria. First, it must lack a residential certificate of occupancy. *Id.* § 281(1). Second, it must have been used, at some point, for manufacturing, commercial, or warehousing purposes. *Id.* And third, it must have served as the

residence of three or more (or in some circumstances two or more) families living independently from one another during specified time periods. *Id.* (occupancy from 1980 to 1981); *id.* § 281(4) (occupancy from 1980 to 1987); *id.* § 281(5) (occupancy from 2008 to 2009); *id.* § 281(6) (occupancy from 2015 to 2016).

Some iterations of the Loft Law, like the one applicable here, also place restrictions, such as minimum square-footage requirements, on which units may qualify for coverage. *Id.* § 281(5). There are additional limitations on the type of occupants who can obtain Loft Law coverage. 29 RCNY § 2-09(b).

The Loft Law's protections are not automatic even when all these criteria are met. Rather, the Loft Law process and its related protections must be initiated by a filing with the Board. The Loft Law mandates that building owners register qualifying units with the Board. MDL § 284(2); *see generally Jo-Fra Props., Inc. v. Bobbe*, 81 A.D.3d 29 (1st Dep't 2010). But understanding that owners may well not register on their own, the Board promulgated a rule that also allows "[a]ny occupant in the building" to "apply for coverage" under the Loft Law. 29 RCNY

§ 2-05(b)(6); *see* 29 RCNY § 2-08(q). "Coverage" means a determination from the Board that a building (or particular units) is subject to the Loft Law, that the occupants are protected by the Loft Law, or both. 29 RCNY §§ 1-06(a)(1)–(2); 2-05(b)(6). The Board's rules governing coverage derive from its express statutory authority to determine "interim multiple dwelling status and other issue of coverage" and to resolve complaints of both owners and tenants. MDL § 282.

The Board has also adopted regulations setting forth the process for making coverage determinations. 29 RCNY §§ 1-06, 2-08; *see* MDL § 282(1) (authorizing the Board to make and enforce rules for, among other matters, hearing coverage applications). If the landlord opposes a tenant's coverage application, the dispute may be resolved during an informal conference before either a designated Board examiner or an Administrative Law Judge (ALJ) at the City's Office of Administrative Trials and Hearings (OATH). 29 RCNY §§ 1-06(j)(1)–(2). If the dispute is not resolved at the conference, a full evidentiary hearing is held before OATH, the City's primary administrative tribunal. *Id.*

In addition to resolving disputes about Loft Law coverage, the Board also hears a wide range of other disputes involving units subject to the law, in keeping with its plenary oversight role. Those include, among other things, disputes about rates of rent, 29 RCNY § 2-01(i), disputes about whether tenants are affording owners sufficient access to units for construction purposes, 29 RCNY § 2-01(g), and disputes about alleged tenant harassment, 29 RCNY § 2-02.

The regulations provide that any agreement by the parties to resolve a dispute becomes effective only after review by the Board's Executive Director and approval by the Board. 29 RCNY § 1-06(j)(5). If the Board rejects an agreement, it "may direct" that the tenant's application be "reopened and remanded for further investigation." *Id.*

B. The Board's rejection of Callen's and the tenants' attempt to contract around the Loft Law

This article 78 proceeding involves a building, known as 430 Lafayette Street Rear, that is owned by the Casper R. Callen Trust and located near Astor Place in Manhattan (Record on

Appeal ("R") 18–19). Petitioner Robinson Callen is the trustee and his company, Salon Realty Corporation, is the managing agent (*id.*). The building shares a lot with another building—430 Lafayette Street Front—that is also owned by the Callen Trust and managed by Salon (R19 n.1, 25, 47, 230). One must pass through the front building to enter the rear building at issue here (*id.*). Only the front building has a residential certificate of occupancy (R113).[2]

1. The tenants' agreement to withdraw their Loft Law coverage application in exchange for Callen's promises of legalization and rent stabilization

In March 2014, the rear building's tenants—petitioner Richard Fiscina and respondents Luke Weinstock, Zenia de la Cruz, and Maria Theresa Totengco—sought to compel Callen to legalize the building under the Loft Law by filing a coverage application, which Callen opposed (R49–51, 60–64, 107–10).

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[2] The front and rear buildings' separate 1918 certificates of occupancy can be found by searching for 430 Lafayette Street in the "Buildings Information" box on DOB's website: https://www1.nyc.gov/site/buildings/index.page.

In January 2015, after informal conferences before an OATH ALJ, Callen and the tenants reached a settlement agreement (R113–27, 139, 277). Its main feature, as the ALJ characterized it, is that "the building would become rent-stabilized without being covered by the Loft Law" (R277).

The agreement memorializes the tenants' and Callen's reciprocal promises. The tenants agreed to withdraw their coverage application with prejudice (R114). In exchange, Callen agreed to register all of the units as rent-stabilized with DHCR, and to "exercise reasonable diligence" in both obtaining an alteration permit and performing the work necessary to secure a residential certificate of occupancy (R117). Out the outset, the parties agreed to negotiate over the scope of Callen's permit application and to arbitrate any disputes (R117–18). Callen promised to "take all reasonable and necessary action" to obtain the permit within 12 months after any such dispute was resolved (R118–19). And Callen aimed to follow the same time frames as the Loft Law provides once a permit was issued (R117).

Key for this case, the parties explicitly recognized the risk that a "government agency may issue violations for illegal use" of the building and "may issue a vacate order" because of the lack of "a certificate of occupancy permitting residential use" (R120). If that happened, Callen promised to "use best efforts to correct the violations and lift the vacate order as quickly as possible" (*id.*).

After the settlement conferences, the OATH ALJ made a recommendation—to deny one occupant's coverage application—that is not at issue here. Beyond that, the OATH ALJ merely presumed the validity of the settlement agreement and the tenants' withdrawal of their coverage application in accordance with the agreement.[3]

[3] The ALJ's report and recommendation, which was inadvertently omitted from the administrative record, is available at http://archive.citylaw.org/wp-content/uploads/sites/17/oath/15_cases/15-357md.pdf (last visited Jan. 7, 2021).

2. The Board's rejection of the agreement as against public policy and remand to OATH to adjudicate the coverage application

On its review pursuant to 29 RCNY § 1-06(j)(5), the Board rejected the agreement as against public policy (R138–41). To the extent the ALJ had recommended permitting the tenants to withdraw their coverage application with prejudice, the Board rejected that recommendation (R139). The Board instead remanded the application to OATH for further adjudication of the coverage application (R138–41), as § 1-06(j)(5) of its regulations expressly contemplates.

The Board explained that, without Loft Law coverage or a residential certificate of occupancy, it was illegal for the tenants to reside in the building (R139–40). It further explained that Callen's DHCR registration does not "legitimize … residential occupancy" without a residential certificate of occupancy (R140). Because residential use of the building remained unlawful, the Board concluded, the proposed settlement agreement "perpetuate[d] an illegality and undermine[d] the purpose" of the Loft Law (*id.*).

In a separate concurrence, the Board's tenant representative noted that Callen and the tenants, in attempting to settle a coverage dispute by stipulating to continued residential use of commercial buildings without Loft Law coverage, were engaged in a "gambit that has been explicitly rejected by the Loft Board in several prior cases" (R143). Because such stipulations violate public policy, the tenant representative observed, they waste the Board's time, probably waste OATH's time, and waste the parties' money on legal expenses for the drafting of "stipulations that cannot pass muster" (*id.*).

Callen and the tenants applied for reconsideration (R146–71, 326–42, 367–70). They offered two main arguments: (1) the building qualified for rent stabilization independently from the Loft Law, so Loft Law coverage was not needed (R150, 154, 156–58, 330, 370); and (2) the Board lacked the authority to stop the tenants from withdrawing their coverage application (R151–56, 330, 370).

The Board denied reconsideration (R173–77). Its Executive Director emphasized that rent regulation and DHCR registration

were irrelevant because residential use of the building remains illegal without a residential certificate of occupancy (R175–76). The Executive Director also pointed out that, in the two years since the parties had executed the agreement, Callen still had not applied for an alteration permit (R176).

Finally, the Executive Director rejected the argument that the Board's remand of the coverage application "forced" Callen and the tenants to litigate (R175–76). Instead of litigating, she noted, (1) the tenants could vacate the building until such time as Callen obtained a residential certificate of occupancy, or (2) Callen could register the building with the Board (*id.*). What the parties could not do is pursue continued illegal occupancy of the building outside of the Loft Law framework.

C. The court orders permitting the tenants and the landlord to evade the Loft Law

1. Supreme Court's order

With support from Weinstock and Totengco, Callen and Fiscina filed separate article 78 petitions alleging that the Board's orders were arbitrary and capricious (R415–45, 535–53, 605–16,

699–718). Supreme Court, New York County (Bluth, J.) granted the petitions in nearly identical orders (R7, 12). The court accepted the rationality of the Board's position "not to approve a settlement it considered inappropriate," but concluded that the Board irrationally disallowed withdrawal of the coverage application (*id.*).

The court deemed it irrational for the Board to reject the withdrawal of the coverage application and "force litigation" (*id.*). In the court's view, it would be "wasteful" and make "no sense" for Callen and the tenants, having "settled their differences," to "spend plenty of money and time litigating something they did not wish to litigate" (*id.*).

2. The First Department's affirmance

The First Department affirmed, with one modification (R729–40). The Appellate Division agreed with the motion court that it was rational for the Board to reject the parties' agreement, but modified the decree to clarify that the article 78 petition was denied to that extent (R737–40).

The First Department also agreed with Supreme Court that it was irrational for the Board to reject the tenants' attempt to withdraw the coverage application (R734–36). "[O]nce the tenants decided to withdraw," the court reasoned, they "relinquished their rights to proceed to conversion pursuant to the Loft Law," thus depriving the Board of authority "to supervise and approve the legalization process" (R738). In the First Department's view, it was also irrational for the Board to reject the withdrawal of the coverage application because the building would apparently "be subject to rent stabilization" once Callen procured a residential certificate of occupancy (R734–36).

JURISDICTIONAL STATEMENT

This Court can hear this appeal because this proceeding originated in Supreme Court, and the First Department's order finally determined it (R729–40). *See* CPLR 5602(a)(1)(i). On January 21, 2020, respondents Weinstock, de la Cruz, and Totengco served notice of entry of the First Department's order by regular mail, which was the only notice of entry served. The Board made a timely motion for leave to appeal on February 24, 2020,

within the statutory 35-day period. *See* CPLR 5513(d). This Court granted leave to appeal on September 1, 2020 (R727).

ARGUMENT

THE FIRST DEPARTMENT ERRED IN ORDERING THE LOFT BOARD TO ABET AN ILLEGAL OCCUPANCY

In annulling the Board's rational determination not to place its imprimatur on the parties' illegal arrangement by approving the withdrawal of the coverage application, the First Department exceeded the proper scope of article 78 review. Such review is limited to an evaluation whether the challenged determination is arbitrary and capricious or lacks a rational basis. CPLR 7803(3); *Matter of Pell v. Bd. of Educ.*, 34 N.Y.2d 222, 231 (1974). And an action is arbitrary and capricious and without a rational basis only when it lacks "sound basis in reason and is generally taken without regard to the facts." *Pell*, 34 N.Y.2d at 231.

Thus, "[i]f the court finds that the determination is supported by a rational basis, it must sustain the determination even if the court concludes that it would have reached a different result than the one reached by the agency." *Matter of Peckham v.*

Calogero, 12 N.Y.3d 424, 431 (2009). When the agency is granted wide discretion, courts "do not have the power to substitute [their] judgment in place of the judgment of the properly delegated administrative officials." *Matter of Save Am.'s Clocks, Inc. v. City of N.Y.*, 33 N.Y.3d 198, 210 (2019) (internal quotation omitted).

But that is precisely what the First Department did here in second-guessing the Board's exercise of its broad statutory authority. At a minimum, the Board acted reasonably by rejecting the proposed settlement agreement and remanding the coverage application, rather than permitting its withdrawal. If the Board had rejected the settlement agreement but allowed withdrawal, it would have effectively endorsed the perpetuation of an illegal living arrangement: ongoing residential occupancy, likely for a substantial time and perhaps indefinitely, without a residential certificate of occupancy or the possibility of Loft Law coverage. By directing the Board to accept the withdrawal of the application despite the invalidity of an agreement premised on the tenants' promise to withdraw the application, the First Department placed the Board in an impossible situation and undercut its own holding

that it was rational for the Board to reject the agreement in the first place.

A. As the First Department held, the Board rationally rejected the proposed agreement because it perpetuated an illegality, evaded the Loft Law, and violated public policy.

As a preliminary matter, the question whether the First Department correctly confirmed the Board's decision to reject the settlement agreement is not properly before this Court. The First Department denied the article 78 petition to the extent it sought to annul the Board's invalidation of the agreement (R737–40). Neither Callen nor any of the tenants have cross-appealed, as they were required to do if they sought to enlarge the relief they have received. *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 151 n.3 (2002).[4]

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[4] Callen's article 78 petition sought, among other relief, an order annulling the Board's determination to reject the settlement agreement (R14–15, 30–44). Tenants Weinstock and Totengco explicitly endorsed that request (R535–53, 699–718). By contrast, tenant Fiscina, brought his own petition challenging only the Board's decision to disallow the withdrawal of the coverage application (R613–16). As to Fiscina, any argument about the validity of the agreement is unpreserved, as well as jurisdictionally barred. *See Bingham v. N.Y.C. Transit Auth.*, 99 N.Y.2d 355, 359 (2003).

We nevertheless proceed to discuss the invalidity of the settlement agreement, given the close connection between that issue and the one before this Court: the rationality of the Board's decision to disallow the withdrawal of the coverage application. In confirming the rationality of the Board's determination to reject the proposed settlement agreement as against public policy, the First Department properly deferred to the Board's knowledge, expertise, and authority to decide issues about the residential occupancy—and conversion to legal residential use—of buildings with commercial certificates of occupancy (R737–38). *See Flacke v. Onondaga Landfill Sys., Inc.*, 69 N.Y.2d 355, 363 (1987).

The Board has the authority to review and reject proposed agreements to settle Loft Law coverage disputes, derived from its broad power to decide issues of Loft Law coverage and to make rules to resolve such issues. MDL § 282. Exercising that authority, the Board promulgated 29 RCNY § 1-06(j)(5), which provides that, where disputes are resolved to the parties' satisfaction, "a stipulation of agreement shall be entered into by the parties and reviewed" by the Board's Executive Director, who provides a

report to the Board. If the Board rejects the settlement agreement, it may then "direct that a particular matter be reopened and remanded for further investigation." *Id.*

The Board's review and rejection of the proposed agreement here was fundamentally a regulatory procedure, given its plenary role in overseeing the legalization of Loft Law units. It is not uncommon for administrative agencies like the Board to adjudicate disputes that arise within their regulatory arena and to require agency approval of settlement agreements reached to resolve disputes informally.

When reviewing a proposed settlement agreement, an agency uses its expert judgment to determine whether the resolution is in accord with the statutory framework it administers and the public policies the statute is designed to achieve. *See Matter of Owners Comm. on Elec. Rates v. Pub. Serv. Comm'n*, 194 A.D.2d 77, 81 (3d Dep't 1993) (dismissing article 78 challenge to approval of agreement to settle utility rate dispute); *Matter of GLC Inv. Co. v. Pub. Serv. Comm'n*, 136 A.D.2d 857 (3d Dep't 1988) (holding that Public Service Commission rationally

approved settlement to discontinue utility service, where settlement both served public interest and avoided follow-on issues).

Accordingly, the inquiry for the Board was whether the proposed settlement agreement complied with the statutory framework and furthered the public policy underpinning the Loft Law. In undertaking that analysis, the Board drew guidance from common-law principles regarding the invalidation of agreements on such grounds (R138–41). But agencies are not bound by these principles. When a court reviews an agency determination to approve or reject a settlement agreement, all that is reviewed is whether the agency's determination was rational. *See Indeck-Yerkes Energy Sers., Inc. v. Pub. Serv. Comm'n*, 164 A.D.2d 618, 621–22 (3d Dep't 1991); *Matter of Caruso v. Ward*, 146 A.D.2d 22, 31–32 (1st Dep't 1989).

Here, the Board rationally rejected the proposed settlement agreement on two grounds. First, the agreement is designed to perpetuate an illegal living arrangement, outside the Loft Law and without any oversight by the Board. Second, the agreement

rests upon a promise by the tenants to waive the Loft Law, a statutory protection designed to benefit the public.

1. The Board rationally rejected a proposed agreement to perpetuate an illegal living arrangement outside the Loft Law.

As the entity the Legislature created to oversee the conversion of commercial buildings to legally occupied residential buildings in compliance with the Loft Law, the Board rationally rejected an agreement to evade the law and its own oversight. The Legislature prescribed a specific conversion process, overseen by a particular regulatory body, the Loft Board. If the Legislature had concluded that private agreements between building owners and illegal residential tenants were sufficient to achieve the Loft Law's goals, there would have been no need for the Loft Law. *See Wolinsky v. Kee Yip Realty Corp*, 2 N.Y.3d 487, 493 (2004).

In their proposed settlement agreement, Callen and the tenants attempted to chart a course outside the Loft Law and without the Board's oversight. Under the agreement, the tenants would continue to reside in the building, but their residential occupancy would be illegal, at least until Callen managed to

secure a residential certificate of occupancy. MDL § 301(1). And of course, the agreement contemplated zero Board oversight of the conversion process. The agreement leaves the tenants to their own devices during a major construction project—Callen's attempt to make the building safe for residential occupancy—undertaken while the tenants continue to reside, illegally, in the building.

The Board rationally rejected an agreement to convert a commercial building for residential use in accordance with a private agreement, instead of in compliance with the Loft Law. There is simply nothing in the Loft Law that offers building owners and tenants a choice between a contractually arranged conversion process and the Loft Law's conversion process. As the regulatory body designated to ensure and oversee compliance with Loft Law, the Board made a rational decision to invalidate an agreement that thumbed its nose at the regulatory scheme.

By failing to comply with the agreement, Callen highlighted its deficiencies, thus handing the Board an additional reason to reject it. Despite the agreement's provision that Callen would "exercise reasonable diligence" in obtaining a permit for the

conversion of the building to residential use, Callen had not filed an application for such a permit by the time of the Board's ruling on reconsideration—more than two years after the agreement's execution (R176). Free from the Loft Law's obligations and the Loft Board's oversight, there is no guarantee that Callen will ever follow through with its promises. The illegality that the agreement embodies could last indefinitely.

The Board's decision to reject the proposed settlement agreement is also supported by the common-law contract principle that agreements to engage in illegal activity are unenforceable. *159 MP Corp. v. Redbridge Bedford, LLC*, 33 N.Y.3d 353, 362 (2019). The proposed agreement is illegal on its face because the parties agreed that the tenants would continue to reside in the building, and Callen would continue to collect rent from them, without (a) a residential certificate of occupancy *or* (b) Loft Law coverage (R113–27). That agreement violates the MDL's residential occupancy provision and its exclusive carve-out for Loft Law-eligible conversions.

MDL § 301(1) states that no multiple dwelling shall be occupied "in whole or in part" without a residential certificate of occupancy, but MDL § 283 provides an exception for units covered by the Loft Law. *See Chazon*, 19 N.Y.3d at 413. As this Court has stated, residences without a residential certificate of occupancy and without Loft Law coverage are "illegal pure and simple: The tenants ha[ve] no right to be there, and the landlords ha[ve] no right to collect rent." *Chazon*, 19 N.Y.3d at 413. What is more, the parties openly acknowledged the agreement's illegality: the agreement recognized that a City agency might issue a vacate order at any time because of the building's illegal residential occupancy (R120).[5] By itself, the facial illegality of the agreement, rendered it unenforceable as contrary to public policy.

[5] City agencies issue vacate orders "to ensure public safety from damaged buildings, illegal conditions, or dangerous conditions that may exist on or near the property." People cannot enter, let alone reside in, buildings with vacate orders. *Violations & Vacates*, N.Y.C. DEP'T OF BLDGS., https://www1.nyc.gov/site/buildings/homeowner/violations-vacates.page (last visited Jan. 7, 2021).

2. It was rational for the Board to reject a proposed settlement agreement that waived a statutory provision designed to provide a benefit to the public.

Beyond the attempt by Callen and the tenants to perpetuate an illegal living arrangement outside the Loft Law, the Board rationally found that the agreement violated public policy because of what it required the tenants to do. In the agreement's key term, the tenants agreed to waive the Loft Law framework by withdrawing their coverage application *with prejudice* (R114). Although the parties to the agreement couch that as a private choice, the Loft Law is a mandatory regulatory regime, and the effects of that purported waiver would have rippled well beyond the tenants themselves. Even if the tenants would prefer to save money by living in a building that does not meet minimum fire and safety standards, they have no right to expose neighbors, children, visitors, service providers, and first responders to the associated risks.

It is in recognition of those risks that the Legislature enacted the Loft Law to "protect the public health, safety and general welfare"—not just to protect tenants who are eligible for

Loft Law coverage. MDL § 280. A private party cannot waive a statutory right that affects the public interest if waiver would contravene the statutory policy. *159 MP Corp.*, 33 N.Y.3d at 361; *Am. Broadcasting Cos. v. Roberts*, 61 N.Y.2d 244, 249 (1984); *Estro Chem. Co. v. Falk*, 303 N.Y. 83, 97 (1951). In other words, an agreement to waive the Loft Law is unenforceable because it is "contrary to the social judgment on the subject [the law] implement[s]." *Matter of Estate of Walker*, 64 N.Y.2d 354, 359 (1985). Neither the administering agency nor the judiciary should "give effect" to an "unsavory transaction" that rejects "an overriding interest of society." *New England Mut. Life Ins. Co. v. Caruso*, 73 N.Y.2d 74, 81 (1989).

This case was not the first time the Appellate Division had found that a waiver of the Loft Law was void as against public policy. The First Department properly found a decade ago that the Loft Law "is not subject to waiver by the tenant." *Matter of Nur Ashki Jerrahi Cmty. v. N.Y.C. Loft Bd.*, 80 A.D.3d 323, 327 (1st Dep't 2010); *cf. Drucker v. Mauro*, 30 A.D.3d 37, 42 (1st Dep't

2006) (agreement waiving rent stabilization would be "indefensible" for a court to enforce).

More recently, in *Matter of Dom Ben Realty v. New York City Loft Board*, the Second Department rejected a purported Loft Law waiver in a case substantially like this one. "[I]irrespective of the benefits conferred by a private agreement upon the parties" to the agreement, the court reasoned, "an individual is incapable of waiving" a right "created for the betterment or protection of society as a whole." 177 A.D.3d 731, 735–36 (2d Dep't 2019) (internal quotation omitted).[6] That is precisely right, and for that

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[6] In *Dom Ben*, the Second Department opined that the severability provision in the agreement there meant that the Board "should have deemed [unenforceable] only those provisions of the settlement agreement that required the tenants to withdraw their coverage applications." *Dom Ben*, 177 A.D.3d at 736. Because no question of severability has ever been raised here, this Court need not wade into this area. That said, the Board offers two observations. First, when, as here, Loft Law coverage is the only question pending before the Board, its review of a purported settlement agreement naturally focuses on the provisions germane to that question, such as whether the agreement to withdraw the coverage application is lawful and consistent with the Loft Law framework. Second, provisions that do not bear on that issue may nonetheless fail to comport with the Loft Law and its regulations for other reasons. For example, a provision purporting to extend legalization timetables would conflict with the express statutory authority of the Board to grant such extensions. As a result, courts should not presume any provision of a purported settlement agreement to be valid absent a determination to that effect by the Board.

reason, as well as the fact that the agreement sought to perpetuate an illegality, the Board rationally rejected the settlement agreement.

B. Contrary to the First Department's holding, it was also rational for the Board to remand the coverage application for resolution.

Once the Board rejected a settlement agreement that would have perpetuated an illegal living arrangement, it made sense to retain jurisdiction and resolve the underlying coverage application, rather than to accept a withdrawal of the application and the perpetuation of the very same illegal living arrangement. The First Department's contrary approach elevates form over substance, confirming the Board's discretion to reject the settlement agreement in principle but compelling the Board nonetheless to abet its implementation in practice. Requiring the Board to endorse the real-world consequences of the agreements it rejects would sharply undercut its review of settlement agreements—and, indeed, its delegated authority.

To the extent the court intended to limit its erroneous holding to situations in which the building is potentially eligible

for rent stabilization, it was wrong there, too. In deeming rent stabilization a suitable alternative to the Loft Law, the First Department ignored the fact that, without Loft Law compliance, residential occupancy of a commercial building during the process of its legalization is unlawful.

1. Having rationally rejected the settlement agreement, the Board rationally remanded the coverage application for further administrative review.

The Board rationally sought to avoid abetting Callen and the tenants in circumventing the Loft Law. Thus, it opted not to sign off on withdrawal of the coverage application, instead continuing to exercise jurisdiction even though the parties wished to leave the Board's oversight. This treatment merely followed the Board's express rule, 29 RCNY § 1-06(j)(5), authorizing it, after rejecting a settlement agreement, to "direct that [the] matter be reopened and remanded for further investigation." The First Department should have deferred to the Board's reasonable interpretation and application of the statute it administers. *Andryeyeva v. N.Y.*

Health Care, Inc., 33 N.Y.3d 152, 174 (2019); *Matter of 902 Assocs. v. N.Y.C. Loft Bd.*, 229 A.D.2d 351, 352 (1st Dep't 1996).

By denying the tenants' attempt to withdraw their application pursuant to the very agreement just deemed illegal, the Board rationally exercised its statutory authority to regulate commercial buildings' residential use to protect residential occupants' health and safety. Had the Board allowed withdrawal, it would have been turning a blind eye to a living arrangement that is not just unlawful, but dangerous for tenants, visitors, neighbors, and first responders.[7] At a minimum, it was rational for the Board not to sign off on a landlord-tenant scheme designed to skirt the statutory process—and regulatory body—that the Legislature created precisely to govern this situation.

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[7] To the extent that the tenants entered into this agreement because of a risk that the Loft Law would not apply, that cannot justify withdrawal. If the units were to fall outside of the Loft Law's coverage, the sole lawful option would be for the tenants to vacate immediately. Only if the units qualify for Loft Law coverage is continued occupancy during legalization, under the Board's oversight, permitted. The risk that coverage may not be available is therefore no basis for the Board, the courts, or anyone else to bless an illegal living arrangement or endorse evasion of the Board's coverage review.

Nevertheless, and without analysis, the First Department told the Board to rubber-stamp the tenants' withdrawal of their coverage application and step aside as Callen and the tenants perpetuated their illegal living arrangement. "[O]nce the tenants decided to withdraw" their application, the court stated, "the Board no longer had authority to supervise and approve the legalization process of the building because the tenants relinquished their rights to proceed to conversion pursuant to the Loft Law" (R738). But the method of conversion was not a matter of choice for the tenants; the Loft Law is the only conversion process that can legalize residential occupancy on an interim basis without a residential certificate of occupancy.

Requiring the Board to go along with withdrawal of a coverage application, notwithstanding continued residential occupancy of the building, undercuts the Loft Law's chief aim. After two years of "intensive negotiations and lobbying efforts," the Legislature enacted the Loft Law to address the health and safety concerns arising from illegal residential use of commercial buildings and "the extreme vulnerability" of their tenants. *S.*

Axelrod Co. v. Mel Dixon Studio, Inc., 122 Misc. 2d 770, 772 (Civ. Ct., N.Y. Cnty. 1983). And the Legislature gave the Board a vital role to play in effectuating legislative intent. That authority is not limited simply to the determination of coverage. It is instead to administer a lengthy and challenging legalization process that may involve many follow-on disputes about varied matters like whether the building is sufficiently fireproof and whether the landlord is charging the proper rate of rent.

When tenants bring an illegal occupancy to the Board's attention by filing a coverage application, a court should not compel the Board to look the other way, and abdicate its statutory responsibilities, merely because the landlord has convinced, cajoled, or coerced the tenants to drop their coverage application. As the Second Department rightly held in *Dom Ben*, tolerating the withdrawal of the tenants' coverage application would effectively allow them to waive the Loft Law and perpetuate an illegal occupancy. 177 A.D.3d at 735. It would also render the Board's authority to review settlement agreements essentially

meaningless, as occupants and owners would just proceed with illegal living arrangements as they pleased.

The result would be an unwarranted boon to building owners. Given the traditional power dynamics between landlords and tenants, building owners would often be well positioned to induce tenants to waive Loft Law protections. They should not be rewarded with the ability to bypass the Loft Law—and Loft Board oversight—simply because their inducements worked. What is worse, under the First Department's decision, the Board is conscripted into aiding and abetting the landlord's gambit.

Nor is this an isolated case. The tenant representative on the Board expressed his frustration with the recurring nature of agreements like this one (R143). And at least two other article 78 proceedings have challenged the Board's rejection of essentially identical arrangements. *See Dom Ben*, 177 A.D.3d 731; *Matter of Parrish v. N.Y.C. Loft Bd.*, Index No. 101595/2013, 2014 N.Y. Misc. LEXIS 1889 (Sup. Ct. N.Y. Cnty. Apr. 24, 2014) (Kern, J.), *appeal withdrawn*, 132 A.D.3d 443 (1st Dep't 2015). Unless

reversed, the First Department's decision will provide a blueprint for the repeat players who practice in this area.

Aside from undermining the Loft Law and the Board, the First Department's position on the withdrawal question also undermined the rest of its decision. Requiring the Board to allow withdrawal effectively swallows whole its recognition of the agreement's invalidity. The court's analysis is particularly puzzling because it was the contract term requiring the tenants to withdraw the coverage application that violated public policy (R114). The First Department thus reached an illogical result: while the tenants could not *contract* to withdraw a coverage application pending a coverage determination, they were perfectly free to withdraw a coverage application in the shadow of that illegal contract.[8]

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[8] None of this is to say that the Board always rejects applications to withdraw coverage applications. The Board generally accepts withdrawals without prejudice when materially changed circumstances obviate the need for the Board's continued jurisdiction, such as where the applicant has moved out of the building. But the Board certainly may rationally decline to accept a withdrawal where, as here, the tenant continues to reside in the building, the withdrawal purports to be with prejudice, and the withdrawal occurs against the backdrop of an illegal agreement to evade the Loft Law.

Contrary to a point urged by Callen and the tenants below, the Board was not improperly "forcing" them to litigate the coverage application. The tenants initiated an administrative proceeding created by a mandatory statutory framework, not a voluntary civil proceeding to resolve a private dispute. Having brought their potentially illegal living arrangement to the Board's attention and then broadcast their intent to skirt the law indefinitely, they could not just walk away and expect that the government would do nothing about it. And the parties had alternatives to litigating, as the Board's Executive Director clearly explained: (1) the tenants could vacate the building until Callen obtained a residential certificate of occupancy, or (2) Callen could register the building with the Board (R175–76). They simply did not have the option of forcing the Board to abet their scheme to maintain illegal occupancy outside of the Loft Law framework.

The First Department's holding is at stark odds not only with the Loft Law's text and the Board's broad authority to implement the statute, but also with the view of the sponsor of the most recent amendment renewing it. Calling the Loft Law's

extension "critical," the sponsor urged the City and the State to "take every opportunity to preserve housing units and make those as safe as possible." Mem. in Support, Bill Jacket, L. 2019, ch. 41. But the City cannot do so if the Board is forced to let tenants withdraw coverage applications in the pursuit of the very dangers and illegality that the Loft Law was designed to combat. To affirm here would be to allow a judicial policy preference to override the Legislature's policy choice—reaffirmed while this case was pending—and weaken the newly extended statutory scheme.

2. Rent stabilization is no substitute for lawful residential occupancy.

Further discounting the Loft Law, the First Department held that it was irrational for the Board to prevent the withdrawal of the coverage application because Callen and the tenants could pursue legalization and rent stabilization by other means (R734–35). That rationale repeats the same error Callen and the tenants made: exalting rent stabilization while ignoring the immediate and antecedent need, satisfied here only by Loft Law compliance,

for legal residential occupancy in the interim period before a residential certificate of occupancy issues.

While it is true that one result of completing the Loft Law conversion process is a multiple dwelling unit subject to rent stabilization, it is by no means true that the availability of rent stabilization is a full and adequate substitute for the Loft Law framework. As a first point, it is questionable whether rent stabilization would be achievable outside the Loft Law. In *Wolinsky*, this Court held that rent stabilization is unavailable for "illegal conversions" that do not qualify for Loft Law protections. 2 N.Y.3d at 490. As the Court observed, "[I]f rent stabilization "already protected illegal residential conversions of manufacturing space, significant portions of the Loft Law would have been unnecessary." *Id.* at 493.

But the Court need not decide whether rent stabilization could be achieved without Loft Law compliance, because the bigger issue is that continued residential occupancy of the building during the interim process of legalization is permissible only under the Loft Law. The First Department implicitly

recognized this, writing that *if* certain rent stabilization doctrines applied, the building "*would* be subject to rent stabilization *once* the residential certificate of occupancy is procured by the owner" (R736) (emphasis added).

The court simply glossed over what happens during the likely years-long process where legalization is being pursued. But as the Court held in *Chazon*, the Loft Law is the sole means for lawful residential occupancy absent a residential certificate of occupancy. *Accord Dom Ben*, 177 A.D.3d at 439 (following *Chazon*). The building's potential eligibility for rent stabilization neither cured the ongoing illegal residential occupancy, nor obligated the Board to allow the tenants to withdraw their Loft Law coverage application while nonetheless continuing to reside in the building.

Nor is there any guarantee that Callen will ever obtain a residential certificate of occupancy outside the Loft Law. DOB cannot issue a certificate of occupancy that changes the zoning use unless it is confident after inspection that the building complies with the Building Code, the MDL, and all other applicable laws

and rules for the new use. New York City Administrative Code §§ 28-118.3.1, 28-118.3.2, 28-118.3.4.1. Callen and the tenants well know that such work needs to be done to the building because the proposed agreement expressly contemplates it (R114–15, 117). For this reason, too, rent stabilization is not a cure-all.

In suggesting otherwise, the First Department misidentified the problem. While noting that a landlord cannot evict "putative rent-stabilized tenants" (R736–37), the court ignored the real risk. As the tenants and Callen acknowledged in the proposed agreement, the government might displace the tenants through an order to vacate the premises because the building lacks a residential certificate of occupancy (R120). This illustrates our core point: because rent stabilization serves no purpose for a building that cannot legally house people, DHCR registration is no substitute for the Loft Law. Nor can the Board be said to have acted irrationally in recognizing that plain fact.

CONCLUSION

This Court should reverse the Appellate Division's order to the extent it requires the Loft Board to accept the withdrawal of the tenants' coverage application.

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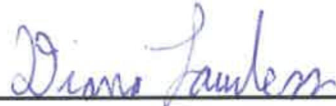
CERTIFICATE OF COMPLIANCE

I hereby certify that this brief was prepared using Microsoft Word 2010, and according to that software, it contains 8,267 words, not including the table of contents, the table of cases and authorities, the statement of questions presented, this certificate, and the cover.



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