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Reviewing a Co-Op's Leases

Areas of Concern and New Model Form to Consider

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THE BASIC RULES of living in a cooperative housing development are set forth in the lease between the tenant/shareholder[1] and the cooperative corporation. This lease is often called a "Proprietary Lease" or sometimes an "Occupancy Agreement," but in either event, it serves as an outline of the obligations and responsibilities of the shareholder to the cooperative corporation and the other shareholders. It also outlines the obligations of the corporation to the shareholder.

However, due to the unique owner/lessee position that a shareholder in a cooperative holds, the lease does much more than simply outline the shareholder's behavior as a tenant. The lease also describes a shareholder's obligations as an "owner" of the apartment, i.e., under what terms he or she may sell or sublease the apartment. It is for this reason that the lease is the single most important document that exists for a shareholder. This is also the reason why the lease should be reviewed by the cooperative corporation on a regular basis. Unfortunately, some cooperatives have never reviewed their leases, and they continue to use the original one found in the offering plan, not because it is an efficient document, but rather because no one has accepted the task of reviewing it. It is incumbent on the cooperative's counsel to recommend such review.

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Can an old lease still be efficient? Certainly, yet this ignores the reality of life. The original lease was written by the sponsor, a person or persons who probably never lived in the building (and, quite frankly, may never have lived in a multiple dwelling). The sponsor's objective was to entice people to buy units in the building, not to include lease provisions which encourage cooperation between neighbors.

In addition, most leases are 30 to 50 years old, and the fact is that times change. For example, more often than ever, shareholders use their homes as an office, shareholders have second homes, and shareholders seems to have needs which are often in conflict with the desires of their fellow cooperators, or which strain the physical limitations of the building in which their unit is located. Finally, and most significantly, people today (including shareholders) are simply more litigious. A lease written in 1955 simply did not anticipate some of these changes in our society.

With this as a background, many attorneys have been asked by their co-op clients to review the clients' leases. In addition, the Council of New York Cooperatives has been hard at work developing a Form of Proprietary Lease, which has finally been released.[2] While preparing the CNYC Form was certainly a grueling task and the document is a valuable one, it must be recognized as being only a tool. It can act as a road map as one reviews the intricacies of the proprietary lease. After 25 years of practice, and having been involved in over 200 cooperatives, this author is confident in stating that it would be rare to find a co-op in New York which would totally discard its lease and adopt the CNYC Form. It is difficult enough for a co-op board to pick a color for its garbage room, let alone for its shareholders to approve an entirely new lease.

Most co-op boards will seek to make a few significant changes, for anything more would confuse their shareholders and complicate matters. The following is a short discussion of a few significant points which should be reviewed, and an analysis of treatment of the issues by the CNYC Form.

Use, Occupancy of Unit

Perhaps the one single provision of a co-op lease that causes the most confusion and debate is the so-called "use" clause. Most leases state that the unit may be used by the shareholder and his or her immediate family. This sounds simple, but there is a question which must be resolved. Does "and" mean "and," or does "and" mean "or"? In other words, if the shareholder moves to Florida, can a member of his/her immediate family move in?

Consider two extreme examples. In one situation, a couple moves to Florida, and their child (who never lived in the unit), a troublemaker who plays an electric guitar all night long and who leaves unwrapped garbage in the hallway, wants to move in. In the other situation a husband and wife have lived together in a unit for 20 years, and now the couple agrees to a trial separation, and the husband (the

sole shareholder) moves out, allowing his wife to stay in the apartment. Should the co-op have a right to reject the proposed arrangements? Should the co-op treat these two family members the same?

At least one court has held that "and" means "or," believing that the unit may be used by the unit owner's family even if the shareholder is not in (nor has ever been in) the unit.[3] In that case a man bought a cooperative and informed the board that he and his wife would live in the apartment. He never did, but his daughter and son-in-law did. The co-op attempted to terminate the lease, and lost. In our two above examples, the court would allow both the separated wife and the problem daughter the absolute right to use the unit.

This issue goes to very heart of what co-ops are all about (and is, in fact, the best and worse aspect of co-ops). Co-op boards can deny the purchase of a unit by someone who it believes will be a bad neighbor or a belligerent shareholder. The concept of picking only nice neighbors is enticing to anyone living in a multiple dwelling. In fact, a number of this author's condo clients have asked if it were possible to make a condo more like a co-op in this respect.

This having been said, if a board has approved one person (the shareholder), why should it be forced to accept another whom they do not even know? Clearly the board has not reviewed the finances of the new person[4], nor interviewed him or her. Why should that person be allowed to use the unit? A board (and its counsel) should determine what position they believe is appropriate and change the lease to reflect that position.

The CNYC Form seems to handle this issue in an effective manner. It states that the unit should be used by "the Tenant-Shareholder and Tenant-Shareholder's Family who reside concurrently with the Tenant-Shareholder." One would hope that this language is clear and not open to interpretation. Interestingly, the CNYC Form defines "family" to not only include children, parents, etc., but also either tenant's spouse, or "one additional adult." Clearly this is a concession to the "roommate law"[5] (and alternate lifestyles), but one must question whether this language may not complicate matters. If the "one additional adult" language was not included, the roommate law would still permit such occupancy in any event.

By defining family to include "one additional adult," the co-op might bestow on a paying subtenant (who lives with the shareholder, but has no other relation with him or her) the same status as a spouse or a life partner. Caution is called for, since this might have an impact on other provisions of the lease (e.g. flip taxes).

Late Fees and Fines

The power of the board of directors to fine defaulting shareholders, and charge late fees to those tenants who do not pay their maintenance in a timely manner, has been a topic of much discussion. One might assume that a board is empowered to create fines under the provision of the lease that provides that the board may create house rules (for what good are rules without some way to enforce them). However, at least one court[6] has, while considering this issue in respect to condominiums (and the power to create fines under the condo bylaws), made its point crystal clear. While the power to fine may be implied, "the better practice would be to expressly enumerate this power." We strongly endorse this position.

The same theory has been applied to late fees. In two early cases[7], courts held that not only must late fees be authorized in the lease, but that they must not be unreasonable. In a more recent case[8], the court reiterated the rule that late fees must be specifically authorized in the lease, and held that a flat fee enacted by the board (as part of its house rules) for late payments was invalid.

The lesson is clear: unless a provision for fines or late fees is included in the lease, charging tenants for these defaults will be close to impossible. In addition, any late fee provision must be specific in authorizing a late fee for any sums due the co-op. Language in a lease which authorizes late fees if rent is overdue may not be permitted when rent (or maintenance) is paid, but other fees (e.g. washing machine fee, etc.) to the co-op are due. It is incredible how many leases have no provision for fines or late fees, and how many managers and boards wish they did.

The CNYC Form envisions "charges and fees" and does an effective job in attempting to broadly define such fees.[9] The author strongly suggests that such a provision be included in every lease. It has been suggested by some attorneys that such charges must still be reasonable in nature and if the board adopts high fees that would be considered punitive, that a court might not permit such fees. We agree.

Objectionable Conduct

No issue directly affects the shareholders on a personal level more than the treatment of "problem tenants." A shareholder's life can be made into a living hell by a neighbor who disturbs the shareholder's sleep each night. Every lease seems to have a provision that states that "objectionable conduct" is a default under the lease. Yet, this language is so vague as to render this provision ineffective. It prompts more questions than answers. Can an "alternative lifestyle" be considered objectionable? Is one domestic verbal battle (albeit at 3 a.m.) a default? It is advisable to carefully scrutinize this provision, and if this language stands alone, a change should be made.

The CNYC Form has attempted to remedy the problem by defining objectionable conduct to include conduct which "permits or tolerates a dangerous condition or dangerous or disruptive person" to be in the building or the unit. This is certainly an improvement. Recently this author has suggested to a client that the definition of objectionable conduct include "conduct which on three separate occasions, during any six month period, has resulted in either (i) written complaints to the board and/or management by at least three different shareholders, or (ii) intervention by the police department."

Will this impress the court? Does this somehow turn what typically is a subjective issue into an objective issue? It is unclear, but it may be worth the effort, for too often we have seen shareholders remain in possession after months of disruptive behavior.

Sale of Units

Another important issue which must be considered when reviewing the co-op lease involves the sale of the unit. The general rule (standard in leases) is that any transfer of the unit is subject to the consent of the board, even a testamentary bequest of the unit. One aspect of this issue involves the delicate situation when a shareholder dies and bequeaths the unit to his or her spouse (or life partner).

The CNYC Form (and many leases) deal with the problem head on. It states that such a transfer is subject to consent of the board, but that such consent shall not be unreasonably withheld if the assignment is to a "financially responsible" spouse or significant other. However, this is troubling. For example, assume a husband (who is the shareholder) and wife live in a unit for 30 years, and the husband dies leaving the widow (who has no income) the unit in his will. Since his costly illness has drained most of their funds, she has a very modest net worth.

Is there anyone who believes that the widow should not be allowed to live out her final years in the unit? Without question, most boards would allow her to stay, but should the board even be given the power to reject her? Perhaps the more humane approach is to simply allow the assignment to the spouse (or life partner) who lived in the unit with the deceased shareholder.

Interestingly, similar language to that used in the CNYC Form was the subject of recent litigation. In that case,[10] the shareholder died leaving his unit to his brother. The lease provided that should the lessee die, consent to an assignment of the lease to a financially responsible relative "shall not be unreasonably withheld." The board rejected the brother without explanation (believing that just as when the board would reject an ordinary purchaser, no reason need be given). The court held that the board was wrong and that its reasons for rejecting the request must be disclosed: "Without specifying its objections and laying them open to scrutiny, [the co-op] cannot justify its refusal simply by arguing that it exercised its 'business judgment' in reaching its determination."

Subletting

Subletting is a constant issue with which a co-op board must contend. Typically, boards must consent to subletting, and often approval is requested when there is a conventional subletting, i.e. when the owner leaves, and a sublessee moves in, paying the owner a sum each month. But every so often a shareholder leaves and a relative moves in. When management or counsel to the co-op speaks with the sublessee (or his/her attorney) in order to remind him or her that consent is required, it is not surprising to hear "This is not a sublet. No money is changing hands."

This is a common mistake, and rather than debate this issue, the CNYC Form takes a very straightforward and logical approach to the problem. The CNYC Form simply states that "Subletting shall include the occupancy of the Apartment by any person not authorized to occupy the apartment, *whether or not any rent is paid by the occupant*." [Emphasis added] This plain language approach to this problem is to be commended.

Many boards have instituted sublet fees, which are payable if and when a sublet is permitted by the board. A board typically considers this within its power, for if a sublet must be approved by a board, why should that board not be permitted to establish certain terms and conditions, including payment of a fee?

One court[11] dealt with this issue, and surprised many with its decision. Though the lease required the consent of the board to any sublease, the lower court and the appellate court found that "since the Bylaws and Proprietary Lease contained no specific authority for the imposition of a surcharge," the sublet fee enacted by the board was invalid. Co-ops should be advised that the lease must contain specific language which allows the board to grant or withhold consent to such subletting, for any or no reason, and on any terms and conditions it may determine. Further, the lease must make specific reference to the right of the board to charge a fee (and it is advisable to include additional costs, such as administrative costs, as well).

It is clear that the proprietary lease is a living document intended to govern the relations between the cooperative and the tenant/shareholders for many years, and must be reviewed every so often. Times change, laws change, and the needs of the cooperatives and their shareholders change.

A careful review of the lease by the board every decade is advisable, and what experience has shown to be the major points of contention, such as those discussed above, is an appropriate starting point for any such review. The CNYC Form has attempted to deal with many of these issues, and has done so effectively. However as every board and every co-op has different needs, any analysis of the lease should be made under the learned eye of the cooperative's attorney.

(1) For the purposes of this discussion, the common phrase "tenant/shareholder" will be shortened to "shareholder."

(2) A revised version will be available in the near future.

(3) *Fifth 912 Corporation, Inc. v. Krupinski*, Sup. Ct., N.Y. Co. *New York Law Journal*, 9/24/96, p.23, col. 2.

(4) While it is true that the person named on the stock certificate and the lease would still be liable for paying the rent, if that person has moved to another state, getting paid may be problematic. The objective of the co-op is to collect maintenance each month, and not just to prevail after many months of complicated litigation.

(5) Real Property Law §235 (f).

(6) *Sweetman v. Board of Managers of Plymouth Village Condominium*, 1998 WL 1112655, April 3, 1998.

(7) *Vernon Manor v. Salatino*, 178 N.Y.S.2d 895 (July 8, 1958); *943 Lexington Avenue, Inc. v. Niarchos*, 373 N.Y.S.2d 787 (Sept. 24, 1975).

(8) *North Broadway Estates, Ltd. v. Schmoldt*, 559 N.Y.S.2d 457 (July 6, 1990).

(9) It is interesting to note the word "charge" is used in the CNYC lease rather than fine. We can only guess this was done due to the fact that "fine" infers some punitive charge.

(10) *Stowe v. 19 East 88th Street, Inc.*, 683 N.Y.S.2d 60 (Jan. 5, 1999).

(11) *Zimiles v. Hotel Des Artistes, Inc.*, 627 N.Y.S.2d 382 (June 8, 1995).