

Tenant's Conditional Contract to Sell His Apartment Upon Conversion to Condominium Ownership Does Not Violate "No Assignment" Clause in Standard Lease

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Horn Waterproofing Corp. v. Bushwick Iron & Steel Co. Reversing the lower court determination, the *Horn Waterproofing* Court held that UCC 1-207 supersedes the common law doctrine of accord and satisfaction in situations involving the tender of negotiable instruments in full satisfaction of disputed debts.

The members of Volume 60 hope that the analysis of the cases contained in *The Survey* will be of interest and value to the New York bench and bar.

DEVELOPMENTS IN THE LAW

Tenant's conditional contract to sell his apartment upon conversion to condominium ownership does not violate "no assignment" clause in standard lease

In New York, the ability of a landlord to convert a rental apartment building into a cooperative¹ or condominium² is condi-

¹ See P. ROHAN, REAL PROPERTY § 9.01 at 9-1 (1981). Cooperatives first gained significance in the United States during the housing shortage after World War I. *Id.* Since then, their popularity has increased dramatically, especially in the bigger cities where it is impractical to build single-family structures due to the scarcity of land. *Id.*; see also P. KEHOE, COOPERATIVES AND CONDOMINIUMS 7 (1974)(more efficient land use necessary in metropolitan areas in mid-1950s). In organizing a cooperative, a corporation is formed and a parcel of real estate is conveyed to it. P. ROHAN, *supra*, § 9.04(4)(a) at 9-13. Prospective tenants then purchase shares of stock in the corporation that are allocated to certain apartments. *Id.* A proprietary lease, and not mere ownership of corporate shares, entitles a stockholder to occupy an apartment. *Id.* A lessee, however, must possess a specific amount of shares in order to obtain a proprietary lease from the cooperative corporation. P. ROHAN, *supra*, § 9.04(4)(a) at 9-13. A cooperative tenant's proprietary lease is actually "a contract for the 'use' of real property, but not a real property interest itself." *Id.*, § 9.03 at 9-6. A tenant's interest in the cooperative is more appropriately referred to as "personalty". See *id.* See generally H. ROTHENBERG, WHAT YOU SHOULD KNOW ABOUT CONDOMINIUMS 21 (1974)(corporation holds title to realty; shareholders receive right to exclusive occupancy and must transfer shares to transfer right of occupancy). For a more extensive look at proprietary leases, see P. KEHOE, *supra*, at 24, and Kamer, *Conversion of Rental Housing to Unit Ownership - A Noncrisis*, 10 REAL ESTATE L.J. 189 (1982).

² See 1 P. ROHAN & M. RESKIN, CONDOMINIUM LAW AND PRACTICE § 1.01(1) at 1-1 (1985). A condominium is "a system of separate ownership of individual units in multi-unit projects." *Id.* Condominiums are a relatively recent phenomenon; through the Horizontal Property Act of 1958, Puerto Rico became the first American legal jurisdiction to authorize them. See P. KEHOE, *supra* note 1, at 8. By 1969, however, all 50 states had enacted laws specifically authorizing condominiums. See *id.* In a condominium, the participants have fee simple ownership of their units individually, and of the common elements as tenants in common in undivided percentages. See D. CLURMAN, F. JACKSON & E. HEBARD, CONDOMINIUMS AND COOPERATIVES 1 (2d ed. 1984); P. ROHAN, *supra* note 1, § 9.02(3) at 9-5; H. ROTHENBERG, *supra* note 1, at 19-20. The ownership of a condominium unit is very similar to owning an individual home because the unit owner must arrange and pay for the financing of the condominium unit. P. ROHAN, *supra* note 1, § 9.02(3) at 9-5. Along with the real estate

tioned upon his obtaining a minimum number of written purchase agreements from the tenants.³ In an effort to attain this statutory minimum, sponsors offer tenants the right to purchase their apartments at a substantial discount as an incentive measure.⁴ The existence of this "insider price" has prompted some tenants to seek profits by devising methods to sell at a premium the advantage accorded by such a price.⁵ Recently, in *Continental Towers Lim-*

taxes on the unit, an owner must pay his percentage of the real estate taxes on the common elements. *Id.* As in the case of individual home ownership, these taxes and the interest on the mortgage are deductible for federal income tax purposes. *Id.*

³ See N.Y. GEN. BUS. LAW §§ 352-eee(2)(c)(i), -eee(2)(d)(i), -eeee(2)(c)(i), -eeee(2)(d)(i) (McKinney 1984). A sponsor may employ either a non- eviction or an eviction offering plan in converting a rental apartment building. See *id.* at §§ 352-eee(1)(b), -eee(1)(c), -eeee(1)(b), -eeee(1)(c). An eviction plan is "[a] plan which . . . can result in the eviction of a non-purchasing tenant by reason of the tenant failing to purchase pursuant thereto. . . ." *Id.* at §§ 352-eee(1)(c), -eeee(1)(c).

In Nassau, Rockland and Westchester Counties, a non- eviction plan requires written purchase agreements from at least 15% of the bona fide tenants in occupancy on the date the plan is declared effective. *Id.* at §§ 352-eee(2)(c)(i), -eee(7). An eviction plan in these counties, however, requires written purchase agreements from: (1) at least 51% of the bona fide tenants in occupancy on the date the Attorney General accepts the plan for filing, excluding the number of eligible senior citizens and disabled persons; and (2) at least 35% of the bona fide tenants in occupancy on the acceptance date including the apartments of eligible senior citizens and disabled persons. *Id.* at § 352-eee(2)(d)(i).

A non- eviction conversion plan in New York City requires written purchase agreements from at least 15% of the bona fide tenants in occupancy or bona fide purchasers (non-tenant purchasers) who represent that they or their immediate family members intend to occupy the unit upon vacancy. *Id.* at § 352-eeee(2)(c)(i). An eviction plan in New York City, however, requires written purchase agreements from 51% of the bona fide tenants in occupancy on the acceptance date, excluding eligible senior citizens and disabled persons. *Id.* at § 352-eeee(2)(d)(i).

⁴ See Goldsmith, *Real Estate Financing*, N.Y. GEN. BUS. LAW § 352, commentary at 32, 49 (McKinney 1984). In an offering plan, "tenants in occupancy" are generally offered a price reduction, occasionally as much as 50% of market value, in an effort to induce them to purchase their units, and thereby help the sponsor meet the minimum purchases requirement. See *id.*; *supra* note 3. The attainment of this minimum is so critical that sponsors occasionally resort to less scrupulous methods of promoting sales. See, e.g., *Richards v. Kaskel*, 32 N.Y.2d 524, 533, 300 N.E.2d 388, 391, 347 N.Y.S.2d 1, 6 (1973)(sponsor falsely informed tenants that offering plan had "gone over the top" to induce them to purchase their apartments); *Gilligan v. Tishman Realty & Constr. Co.*, 283 App. Div. 157, 163, 126 N.Y.S.2d 813, 818 (1st Dep't 1953)(sponsor threatened tenants that if they did not purchase their units they would be "sleeping in Central Park"), *aff'd*, 306 N.Y. 974, 120 N.E.2d 230 (1954).

⁵ See, e.g., *University Mews Assoc. v. Jeanmarie*, 122 Misc. 2d 434, 438, 471 N.Y.S.2d 457, 460 (Sup. Ct. N.Y. County 1983) (prior to closing, tenants contracted to sell apartment shares to third parties subsequent to closing to generate profit equal to difference between insider and outsider price). Much confusion and litigation has arisen in recent years as to who has the right to purchase at an insider price. See, e.g., *Consolidated Edison Co. v. 10 W. 66th St. Corp.*, 61 N.Y.2d 341, 462 N.E.2d 367, 474 N.Y.S.2d 267 (1984)(whether corporate tenant was "tenant in occupancy" entitled to right to purchase apartment at insider price);

ited Partnership v. Kratalic,⁶ the Appellate Term, First Department held that a tenant did not violate a standard lease provision prohibiting the unauthorized assignment of the lease when he conditionally contracted to sell his apartment upon conversion to condominium ownership.⁷

In *Continental*, the plaintiff landlord filed an offering plan with the Attorney General of the State of New York⁸ seeking to convert his rent stabilized apartment building to condominium ownership.⁹ Prior to the Attorney General's approval of the conversion plan, the tenants contracted with a non-tenant purchaser to convey their apartment to the "outsider," contingent upon the tenants' acquisition of the unit and the implementation of the conversion plan.¹⁰ The contract also provided that the third-party buyer was to advance to the tenant-sellers the funds necessary to purchase the condominium unit at the insider price, along with an additional \$25,000 premium, as consideration.¹¹ The landlord brought an eviction proceeding against the tenants alleging that this contract was a violation of the standard lease clause which prohibited assignments of the lease without prior written consent.¹² The Civil Court of the City of New York, New York

Hohenstein v. Hohenstein, 127 Misc. 2d 53, 485 N.Y.S.2d 170 (Sup. Ct. Queens County 1984)(husband who had separated from wife and moved out of apartment sought to purchase as "tenant in occupancy" upon wife's death); *Stuart v. One Sherman Square Assoc.*, 123 Misc. 2d 414, 473 N.Y.S.2d 669 (Sup. Ct. N.Y. County 1984)(one co-tenant sought to enjoin another co-tenant from purchasing unit upon conversion at insider price); *cf. Freudenstein v. 645 Co.*, 128 Misc. 2d 635, 493 N.Y.S.2d 681 (Sup. Ct. N.Y. County 1985)(whether right of statutory tenant to purchase at insider price passed to estate upon his death); *In re Lipkowitz*, 127 Misc. 2d 77, 485 N.Y.S.2d 466 (Sup. Ct. N.Y. County 1985)(whether executor had right to purchase on behalf of deceased tenant's estate).

⁶ N.Y.L.J., July 22, 1985, at 6, col. 2 (Sup. Ct. App. T. 1st Dep't 1985).

⁷ *Id.*; see also *Wise, Tenant Allowed to Sell Rights to Co-Op at 'Insider' Discount*, N.Y.L.J., July 22, 1985, at 1, col. 3.

⁸ See *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2. See generally N.Y. GEN. BUS. LAW § 352-e(1)(a) (McKinney 1984)("public offering or sale in or from the state of New York of securities constituted of participation interests or investments in real estate" must be registered with attorney general); Goldsmith, *supra* note 4, at 33-34 (language of § 352-e(1)(a) sufficiently broad to include condominiums and cooperatives).

⁹ See *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2.

¹⁰ *Id.*

¹¹ *Id.* In *Continental* the contract stipulated that the \$25,000 premium was to be paid in three separate installments: "(i) \$5,000 upon execution of [the] agreement; (ii) \$3,000 upon seller vacating the apartment unit . . . and, of course, there follows (iii) a balance of \$17,000 at time of closing . . ." Record on Appeal at 39, *Continental Towers Ltd. Partnership v. Kratalic*, N.Y.L.J., July 22, 1985, at 6, col. 2 (Sup. Ct. App. T. 1st Dep't 1985)[hereinafter cited as Record on Appeal].

¹² *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2.

County, dismissed the petition, and the landlord appealed.¹³

The Appellate Term, First Department rejected the landlord's contention that the lease was violated, ruling that there had been no actual assignment of the lease.¹⁴ In reaching this result, the court noted that the tenants were still in possession of the unit at the time of the trial and had not transferred a right of present occupancy to the non-tenant purchaser.¹⁵ The appellate term determined that the contract was not to become effective until the landlord-tenant relationship had been terminated by the respondent's acquisition of his unit subsequent to the conversion of the building.¹⁶ The court unanimously concluded that the "conditional agreement" to sell the apartment unit did not constitute a breach of the "no assignment" clause in the lease.¹⁷

It is submitted that the holding in *Continental* did little to clear up the gray area surrounding the transferability of the right to purchase at an insider price. In addressing only the narrow issue of whether the agreement violated the "no assignment" clause in the lease, the court did not reach the broader question of the assignability of the right to purchase at the insider price.¹⁸ It is sug-

¹³ See *id.* The landlord's petition was dismissed with prejudice, and possession of the premises was awarded to the tenant. See Record on Appeal at 2.

¹⁴ *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2. But see Record on Appeal at 75 ("a very close point" as to whether or not contract of sale was assignment).

¹⁵ *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2. The court noted that the tenants would have been required to vacate the premises only upon the transfer of ownership to the third-party buyer. *Id.*

¹⁶ *Id.*; see also Record on Appeal at 75 ("[The purchaser has] never asked [the tenant] for the assignment . . . and he hasn't given it yet. . . . What you've done here is - to put it more formally - he has agreed to give an assignment upon the happening of certain events. They have not taken place yet.") (remarks of Judge Sparks at trial).

¹⁷ *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2. The contract in *Continental* specified that if the purchaser desired an assignment of the tenant's lease term, the written consent of the landlord would be necessary. *Id.* Thus, the tenants specifically contracted to obtain the landlord's approval in the event they wished to assign the lease. *Id.*

¹⁸ See *Continental*, N.Y.L.J., July 22, 1985, at 6, col. 2. In a similar case involving conditional sales, another court did reach the merits of the validity of the contract. See *University Mews Assoc. v. Jeanmarie*, 122 Misc. 2d 434, 442, 471 N.Y.S.2d 457, 463 (Sup. Ct. N.Y. County 1983). In *University Mews*, the owner-sponsor of a rent stabilized building filed a cooperative offering plan with the New York State Attorney General. *Id.* at 436, 471 N.Y.S.2d at 459. Several tenants contracted with outsiders to purchase their apartments at the insider price and to resell the apartments to those outsiders at a premium. *Id.* at 438, 471 N.Y.S.2d at 460. Although the facts were almost identical to those underlying *Continental*, the court in *University Mews* ruled on the validity of the contracts, referring to them as "equitable assignments . . . that became legal assignments upon title closing." *Id.* at 442, 471 N.Y.S.2d at 463.

An equitable assignment creates a title in an assignee which will be recognized and

gested that far from clarifying the assignability of this right, the court may have complicated the issue further by inviting landlords to devise lease clauses that *can* withstand judicial scrutiny and thereby create roadblocks for tenants who wish to indirectly assign their rights in the manner attempted in *Continental*. In addition to employing such lease clauses, it is submitted that building owners seeking to convert can condition offers to convey at insider prices with language that precludes any possibility of circumvention.¹⁹ However, such language must adequately cover the event in question, or a court may construe the clause narrowly and hold in favor of a tenant-seller.²⁰ A cooperative or condominium board also has at its disposal the right of first refusal, but the utility of this device is rather limited.²¹ In cooperative conversions, the imposi-

protected by a court of equity. See Comment, *Creation of an Equitable Assignment*, 21 ST. JOHN'S L. REV. 202, 202 (1947). A court of law, however, will not recognize such an assignment "because either the legal title to the property or fund assigned has not passed or the thing assigned is not *in esse* at the time." *Id.* On the other hand "an assignment is an actual or constructive transfer of some species of property, or interest in property with a clear intent at the time to part with all interest in the thing transferred." *Id.*

¹⁹ See *De Christoforo v. Shore Ridge Assoc.*, 126 Misc. 2d 339, 340, 482 N.Y.S.2d 411, 412 (Sup. Ct. Kings County 1984) ("sponsor, drafter of the agreement, may condition his offer at an 'insider price' in any manner he chooses, subject to the applicable statute and approval of the Attorney-General [sic]").

²⁰ See *University Mews Assoc. v. Jeanmarie*, 122 Misc. 2d 434, 471 N.Y.S.2d 457 (Sup. Ct. N.Y. County 1983). In *University Mews*, the cooperative offering plan included a subscription agreement which stated that the rights under the agreement were not assignable without the consent of the corporation and that an assignment without such consent would be null and void. *Id.* at 437, 471 N.Y.S.2d at 459. The agreement also provided that the cooperative shares were to be purchased for the tenant's own account and for his personal occupancy. *Id.* at 437, 471 N.Y.S.2d at 460. The offering plan, however, provided that the tenant could sell and assign his proprietary lease at any time as long as he complied with the provisions of the proprietary lease and the by-laws. *Id.* The court held that the tenant was free to assign "where the contract to sell is *executed before* title closing so long as it is *effective thereafter following tenant-shareholders' personal occupancy, however brief, of the co-operative apartment and is subject to tenant shareholder's compliance with . . . the proprietary lease.*" *Id.* at 443, 471 N.Y.S.2d at 463; see also *De Christoforo v. Shore Ridge Assoc.*, 126 Misc. 2d 339, 340, 482 N.Y.S.2d 411, 413 (Sup. Ct. Kings County 1984) (sponsor's omission of clause in offering plan precluding specific event must be construed against him). But see *Sini v. Hyngstrom*, 109 App. Div. 2d 671, 671, 486 N.Y.S.2d 253, 254 (1st Dep't 1985) (clause prohibiting assignment of right to purchase under subscription agreement enforceable, even though there was no provision rendering assignment with corporation's consent void).

²¹ See *Bachman v. State Div. of Human Rights*, 104 App. Div. 2d 111, 114, 481 N.Y.S.2d 858, 860 (1st Dep't 1984) (cooperative board of directors had "contractual and inherent power" to exercise right of first refusal absent discrimination prohibited by law); P. КЕНОЕ, *supra* note 1, at 47. Upon exercise of the right of first refusal, a cooperative or condominium board is usually required to purchase the unit at the same price that the seller could have received from the rejected buyer. *Id.* In the long run, the tenant-seller sells the

tion of a "flip tax" in the apartment corporation's by-laws may further discourage transfer schemes of tenants²² - although the sponsor of a condominium conversion may not be able to avail himself of this weapon.²³

While the courts have demonstrated some degree of flexibility in permitting purchases at insider prices,²⁴ it is submitted that fur-

unit or shares as he had originally planned. *Id.* In a condominium, the right of first refusal may be restricted by the common law rule which "prohibits unreasonable restraints on the transfer of a real estate title." *Id.* See generally D. CLURMAN, F. JACKSON & E. HEBARD, *supra* note 2, at 92 (condominium board may exercise right of first refusal and purchase unit at best outside price offered after unit owner gives notice of proposed sale); Note, *Condominiums and the Right of First Refusal, Symposium on the Law of Condominiums*, 48 ST. JOHN'S L. REV. 1146, 1146 (1974)(right of first refusal exercised by cooperative board to promote "harmonious living").

²² See D. CLURMAN, F. JACKSON & E. HEBARD, *supra* note 2, at 92. A board of directors will often enact a provision in its by-laws providing that, upon resale of a cooperative unit, a percentage of the profits will be payable to the board. *Id.*; see, e.g., *Mayerson v. 3701 Tenants Corp.*, 123 Misc. 2d 235, 235, 473 N.Y.S.2d 123, 124 (Sup. Ct. N.Y. County 1984) (transfer fee imposed to discourage purchasers from engaging in speculative practices); *University Mews Assoc. v. Jeanmarie*, 122 Misc. 2d 434, 443, 471 N.Y.S.2d 457, 463 (Sup. Ct. N.Y. County 1983)(under proprietary lease, cooperative corporation could "set reasonable legal and other expenses including a so-called 'flip' tax"). The enactment of a transfer fee or "flip tax" is derived "from the inherent powers of a Board of Directors to manage the affairs of the property." *Mayerson*, 123 Misc. 2d at 236, 473 N.Y.S.2d at 124. *But see Frymer v. Bell*, 99 App. Div. 2d 91, 93, 472 N.Y.S.2d 622, 624 (1st Dep't 1984)(transfer fee of "20% of the difference between the prospectus price and the 'market value' of the apartment . . . arbitrarily fixed at 3.75 times the prospectus price" deemed illegal exaction with no lawful basis); *330 W. End Apartment Corp. v. Kelly*, 124 Misc. 2d 870, 874, 478 N.Y.S.2d 220, 223 (Sup. Ct. N.Y. County 1984)(under terms of proprietary lease, cooperative board of directors failed to obtain necessary shareholder approval to assess flip tax on tenant for sale and assignment of his lease to third party).

²³ See Siegler, *Is a Condominium Flip Tax Permissible?*, N.Y.L.J., Apr. 3, 1985, at 1, col. 1. The common law rule prohibiting illegal restraints on alienation may operate to invalidate a resale fee in the area of condominiums. See *id.*; cf. *supra* note 21 (right of first refusal may be unreasonable restraint on alienation); *Laguna Royale Owners Assoc. v. Darger*, 119 Cal. App. 3d 670, 683-84, 174 Cal. Rptr. 136, 144-45 (Cal. Ct. App. 1981)(restriction on right of alienation of condominium will be upheld if rationally related to protection of property, nondiscriminatory, and consequences of restriction are not severe); *White Egret Condominium, Inc., v. Franklin*, 379 So. 2d 346, 350 (Fla. 1979)("condominium restriction or limitation does not inherently violate a fundamental right and may be enforced if it serves a legitimate purpose and is reasonably applied"). Cooperatives and condominiums are similar in that they both involve "the close proximity of residents and the use of common facilities." See Siegler, *supra*, at 32, col. 3. Thus, the lifestyle afforded by both is more restrictive than one would encounter in a single-family detached house. *Id.* Although the cooperative form of ownership does not involve a fee simple interest in realty, the use of flip taxes in the realm of condominiums would promote similar policy considerations concerning "shared living facilities" that justify resale fees in a cooperative corporation's by-laws. See *id.*

²⁴ See, e.g., *Consolidated Edison Co. v. 10 W. 66th St. Corp.*, 61 N.Y.2d 341, 344-45, 462 N.E.2d 367, 368, 474 N.Y.S.2d 267, 268 (1984)(corporation entitled to purchase at insider price through corporate designee); *In re Lipkowitz*, 127 Misc. 2d 77, 80, 485 N.Y.S.2d 466,

ther judicial or legislative guidance is necessary to define the ability of tenants to transfer the right to make such purchases. It is suggested, however, that future guidelines should not restrict transferability to an extent which might discourage home ownership and the societal benefits which flow therefrom,²⁵ but rather, should regulate to the degree necessary to resolve the disputes which will undoubtedly arise as both tenants and sponsors struggle to devise more creative means of promoting their respective interests in the transferability issue.

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CPL § 190.25(4); The disclosure of grand jury testimony in a subsequent civil action

Since the fourteenth century, grand jury proceedings have been held in secret.¹ In New York, this practice has been codified

469 (Sup. Ct. N.Y. County 1985)(executor had both right and duty to purchase unit for deceased tenant's estate); *Hohenstein v. Hohenstein*, 127 Misc. 2d 53, 56, 485 N.Y.S.2d 170, 172 (Sup. Ct. Queens County 1984)(husband remained "tenant in occupancy" and was entitled to purchase at insider price after separation from wife even though he could not physically occupy apartment until her death).

²⁵ See Ch. 555, § 1, [1982] N.Y. Laws 2396. "[T]he conversion of residential real estate from rental status to cooperative or condominium ownership is an effective method of preserving, stabilizing and improving neighborhoods and the supply of sound housing accommodations." *Id.*; see Rohan, "The Model Condominium Code" - A Blueprint for Modernizing Condominium Legislation, 78 COLUM. L. REV. 587, 599 (1978)("occupier-ownership in the form of . . . condominiums offers the best long-range solution to the problem of urban decay").

The condominium form of ownership may provide a lower-income family with its only opportunity to purchase a unit having the same characteristics as the "traditional single-family detached house." *Id.* In addition to the tax advantages and the ability to share in the management of the condominium, such families would gain a sense of pride and fulfillment in being the owners of the apartment. *Id.* This pride of ownership cannot exist without the right to profits. *Id.* at 133.

¹ See M. FRANKEL & G. NAFTALIS, *THE GRAND JURY* 9 (1977). The grand jury dates back to 1166 when King Henry II formed the Assize of Clarendon to serve as an investigatory and law enforcement body. See *id.* at 6-7. The hearing of testimony in private became a practice of the grand jury during the fourteenth century. See *id.* at 9. It was not until some 200 years later, however, that the grand jury broadened its role to include the protection of the innocent from unfounded accusation. See *id.*

The five most frequently cited reasons for maintaining grand jury confidentiality are: