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From:	Alan Epstein Arlo M. Chase	
Date:	June 4, 2003	File No.: 52304.001
Subject:	Follow-up Memo on Mitchell-Lama Conversion Impact Bill	

Introduction

This memo is meant to serve as a brief addendum to our legal back-up memo of April 14 (copy enclosed) in order to respond to some of the comments and questions raised by the three of you at the May 16 meeting concerning the proposed Mitchell-Lama Conversion Impact Bill. In addition to this memo, we are submitting a revised Mitchell-Lama Conversion Impact Bill (as revised, the "Bill"), which we believe addresses the most significant of the comments and recommendations you expressed at the meeting. To the extent the points raised at the meeting are addressed in the Bill, we do not discuss them in this memo.

Urstadt Law

A question was raised at the meeting as to whether the Bill would violate the Urstadt Law. The Urstadt Law is found at § 8605 of the Unconsolidated Laws of the State of New York, and states in relevant part as follows:

Notwithstanding the foregoing, no local law or ordinance shall hereafter provide for the regulation and control of residential rents and eviction in respect of any housing accommodations which are (1) presently exempt from such regulation and control or (2) hereafter decontrolled either by operation of law or by a city housing rent agency, by order or otherwise. No housing accommodations presently subject to regulation and control pursuant to local laws or ordinances adopted or amended under authority of this subdivision [L. 1997, c. 1116] shall hereafter be by local law or ordinance or by rule or regulation which has not been theretofore approved by the state commissioner of housing and community renewal subjected to more stringent or restrictive provisions of regulation and control than those presently in effect.

The Bill would not be in violation of the Urstadt Law since the Urstadt Law by its terms only applies to laws which “provide for the regulation and control of residential rents and eviction.” The Bill increases the requirements on owners seeking to exit the Mitchell-Lama Program, but does not in any way regulate residential rents or eviction.

Contract Clause Violation

A concern expressed at the meeting was that the Bill would be subject to challenge on the grounds that it impermissibly changes the agreement between the State and the Mitchell-Lama owners reflected in the Private Housing Finance Law (“PHFL”); specifically that after the requisite 20-year period, a Mitchell-Lama owner may opt-out of the program requirements.¹ We understand this concern to be that, by making the opt-out process more burdensome and expensive, the Bill infringes on the contractual rights of the owners under the statute.

This argument is of course dependent on the premise that the owners’ right to opt-out of Mitchell-Lama program is a contractual right. The test to determine whether legislation creates a contractual obligation for the government under New York law is whether the statutory language is “susceptible of no other reasonable construction than that a contract was intended.”² Applying this test to the Mitchell-Lama statute, it is clear that the right to opt-out of the Mitchell-Lama program is not a contractual right. Section 35(2) of the PHFL states only that, after the requisite 20-year period, a Limited Profit Housing Company (“LPHC”) “may voluntarily be dissolved.” This statutory language does not approach contractual language; it does not address specific parties and it does not use language which binds the government.³ In a recent case challenging the application of the Rent Stabilization Code to Mitchell-Lama developments completed before 1974, the Court of Appeals for the Second Circuit ruled that the Mitchell-Lama statute does not confer any contractual rights on owners of Mitchell-Lama developments.⁴

The likelihood that any contractual-based challenge to the law based would be rejected is strengthened by the fact that the existing HPD and State regulations governing the opt-out process, which already create significant administrative burdens on owners, have not been successfully challenged. See 28 RCNY § 3-14(i)⁵; 9 N.Y.C.R.R. § 1750.1 et seq. HPD’s

¹ See NY Priv.Hous.Fin.L. § 35(2).

² Methodist Hospital of Brooklyn v. State Insurance Fund, 64 N.Y.2d 365, 377 (1985) (internal quotation marks and citations omitted); Penn R.R. Co. v. State of New York, 11 N.Y.2d 504, 511-12 (1962) (extensive discussion).

³ Compare this language with that used in another part of the PHFL, specifically the section creating the New York State Housing Finance Agency. That statute explicitly provides that the state “does hereby pledge to and agree with the holders of any notes or bonds issued under this article” that their rights will not be impaired. See NY Priv.Hous.Fin.L. § 48. As noted in a law review article, by using this explicit contractual language in another section of the same chapter of the state laws, the failure of the opt out section to use such contractual language is even more evident. See David J. Sweet & John D. Hack, Mitchell-Lama Buyouts: Policy Issues and Alternatives, 17 Ford.U.L.J. 117, 141 (1989).

⁴ See West 95 Housing Corp. v. NYC Department of Hous. Pres., & Dev’l, 31 Fed..Apx 19, 2002 WL 355951 (2nd Cir. March 5, 2002).

⁵ This Section was previously found at 28 RCNY § 3-14(k).

regulations currently require LPHCs to, among other things, (i) give notice of intent to dissolve one year before the scheduled date of dissolution, (ii) provide HPD for its review and approval an accountant's schedule of all accounts payable, taxes due and any other indebtedness, and (c) provide residents with notice of the intent to dissolve and hold at least one public information meeting with the residents to discuss the dissolution. 28 RCNY § 3-14(i)(2)-(4), (10), (11).

As discussed in the Fordham Urban Law Review, the State and City regulations have been discussed in two court cases. First, in Winthrop Gardens, the Albany Supreme Court reportedly held that DHCR's regulations did not prohibit an owner from opting-out and, even though they slowed the process and made it more expensive, such regulations did not exceed the agency's regulatory authority.⁶ Second, in 2250 Olinville Avenue Inc. v. Crotty, in holding that HPD's opt-out regulations could not be applied retroactively, the Court suggested that the regulations were valid as applied to future opt-out scenarios. The court stated that "the contractual right to repay the mortgage [and opt-out] may be procedurally altered by municipal regulation."⁷ The Bill's further requirements of LPHCs, to pay an administration fee and complete a study and mitigation, do not alter the nature of HPD's existing regulations.

Authority to impose fines for non-compliance

Another question was raised as to whether HPD can, as a part of the process by which owners of Mitchell-Lama developments subject to City supervision remove such developments from the regulation of the Mitchell-Lama program, require those owners to pay fines if HPD finds that the development was not in substantial compliance with the essential Mitchell-Lama regulations and such non-compliance caused the City and/or the Tenants material injury. As we understand it, the concern raised about this aspect of the Bill was that the governing state statute does not authorize HPD to impose such fines.

Initially we note that, after examining the caselaw, we have changed the language in the Bill to authorize HPD to impose a "civil penalty" rather than a "fine."⁸ More substantively, we believe that requiring owners to pay civil penalties for non-compliance with the essential Mitchell-Lama regulations is properly interpreted as an implicit aspect of the City's statutorily granted authority over City-aided Mitchell-Lama developments, and in particular the specific statutorily granted authority to ensure compliance with the Mitchell-Lama regulations. As detailed extensively in our April 14 memo, the PHFL grants the City (through HPD) broad authority to set rules for, supervise, review and monitor LPHCs and Mitchell-Lama Housing developments.

⁶ See David J. Sweet & John D. Hack, Mitchell-Lama Buyouts: Policy Issues and Alternatives, 17 Ford.U.L.J. 117, 141 (1989), discussing Matter of the Application of Winthrop Gardens, Inc., Sup. Ct. Albany Co., Index No. 9381/87, slip op. (February 22, 1988).

⁷ See 2250 Olinville Avenue Inc. v. Crotty, 532 N.Y.S.2d 996,997 (Sup. Ct. 1988)

⁸ See In the Matter of Dumbarton Oaks Rest., 58 N.Y.2d 89, 93-94 (1983) (describing fines as an "exaction for a criminal violation imposed by court ... while a penalty is a sum of money for which the law exacts payment by way of punishment for doing some act which is prohibited or omitting to do some act which is prohibited.") (citing other cases).

In addition to the innumerable specific grants of regulatory authority, the PHFL grants to the City the “exclusive power to promulgate such supplementary rules and regulations ... as may be necessary to carryout the provisions of the [Mitchell-Lama Program].”⁹ Even more on point, Section 32 of the PHFL assigns broad powers to the City to investigate and to ensure compliance with the various Mitchell-Lama regulations and requirements. We further note the well-established provision that municipalities in New York State are not limited to the explicit powers granted in statutes but have significant implicit authority to enforce their given statutory powers.¹⁰

Given the above-described extent of the regulatory authority granted to HPD by the PHFL to govern Mitchell Lama developments and the general legal principles at play, we would expect the courts to hold that HPD does indeed have the authority to require owners to pay a civil penalty for non-compliance. As you might expect, there is no caselaw directly on point. Surprisingly, there are remarkably few New York cases which discuss a regulatory agency’s authority to enact fines or civil penalties over the public it regulates in the absence of explicit statutory authorization to do the same.

One of the few cases which deals with this issue is Ahsaf v. Nyquist 37 N.Y.2d 182, 184 (1975), in which the court “confronted a case ...involving the imposition of a penalty by an administrative agency on a member of the public over whom it has regulatory authority.” Quoting Matter of Butterfly & Green v. Lomenzo, 36 N.Y.2d 250 (1973) (1973) the Ahsaf court held that “[w]here an administrator is clothed by the Legislature with responsibility of licensing and disciplining a calling, he must not be denuded of the commensurate authority to punish those licensees who violate professional standards unless his measures are shockingly unfair.”

This holding of Ahsaf and Matter of Butterfly would likely apply to any challenge to the Bill’s authorization of penalties against owners of Mitchell-Lama developments. While Mitchell-Lama developments are not technically “licensees” of HPD, HPD’s regulatory authority over Mitchell-Lama developments operates in a similar manner. HPD’s oversight of Mitchell-Lama developments begins at conception, as HPD is required to approve the creation of the Limited Profit Housing Company LPHC (and the principals thereof), the legal entity which must own the Mitchell-Lama project.¹¹

HPD’s areas of regulation over LPHCs and Mitchell Lama developments also include:

- setting allowable rents,¹²
- approving any and all alterations and improvements to developments,¹³

⁹ See NY Priv.Hous.Fin.L. § 23-(2).

¹⁰ See, e.g. General Contractors Ass’n of N.Y. v. Tormenta, 687 N.Y.S.2d 871, 874 (N.Y. Supt. Ct. 1999) aff’d 696 N.Y.S.2d 155 (1st Dep’t 1999); City of Albany v. McMorran, 230 N.Y.S.2d 421, 432-33 (Albany Sup. Ct. 1962) (citing cases).

¹¹ See 28 RCNY §3-01, NY Priv.Hous.Fin.L. § 13.

¹² See 28 RCNY §3-02-03, NY Priv.Hous.Fin.L. § 31(1), (9).

¹³ See NY Priv.Hous.Fin.L. § 27(4)(a).

- reviewing the LPHCs' annual budgets and quarterly financial statements,¹⁴
- investigating the affairs of a LPHC by requiring a LPHC to offer testimony and submit records¹⁵, and
- supervising the boards of directors of the LPHCs and removing directors thereof for any violations of the statute or regulations.¹⁶

It is therefore clear that HPD serves much like a licensing agency for LPHCs and Mitchell-Lama developments and the Ahsaf holding suggests that HPD can indeed implement civil penalties to punish LPHCs for non-compliance.¹⁷

Rent Stabilization

A question was also raised concerning Section I(5) of the Bill, and whether the appropriate inquiry for rent stabilization purposes is when the building was "completed" or "occupied." According to the governing DHCR Regulations, 9 NYCRR § 2520.11(e), buildings are exempt from rent stabilization in the City if they are "completed or substantially rehabilitated" on or after January 1, 1974. Therefore, we believe the current phrasing of the Bill is accurate.

Conclusion

In conclusion, it may be helpful to recall that the regulations implemented by the Bill do not come in a vacuum absent of policy considerations. Indeed, the determination in 1987 to first develop and impose regulations governing the opt-out process was an explicit statement of policy by the City as this issue began to emerge. And more recent statements by HPD to the effect that it chooses to deal with opt-outs/conversions on a case-by-case basis are also a statement of current policy and do not seem to constitute the city's analysis of all of its regulatory options and remedies.

Therefore, the legislative findings set forth in the Bill explicitly provide that the Bill sets forth a new statement of policy by the City, namely that what remains of the City Mitchell-Lama housing stock should be preserved as affordable housing for as long as possible, and that all necessary steps shall be taken to achieve that goal – within the framework of the law.

In sum, we believe the Bill's requirements on Mitchell-Lama owners are within the scope of the City's authority and do not impermissibly interfere with the owners' rights to exercise their rights under the PHFL. We look forward to a continuing dialogue as this Bill progresses to introduction and consideration.

¹⁴ See 28 RCNY §3-7(g)(2), NY Priv.Hous.Fin.L. § 32-a(6).

¹⁵ See NY Priv.Hous.Fin.L. § 32(5).

¹⁶ See 28 RCNY §3-13, NY Priv.Hous.Fin.L. § 32(6).

¹⁷ Because we have changed the Bill to authorize the imposition of a civil penalty and not a fine, we feel that a court would not be persuaded that other cases are controlling. See In the Matter of Nostima Foods, Inc., 71 N.Y.2d 648, 651-2 (1999). That case discussed the authority of the State Liquor Authority to impose fines.

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