SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Application of WESTVIEW TASKFORCE, INC. and JANET M. SHEA, YADIRA CERRATO, HIRAM JACOBS, VIRGINIA CHAMBERS and PETER ALBER, on behalf of Westview Taskforce, Inc., the official Tenants' Association for the buildings located at 595 and 625 Main Street, Roosevelt Island, Petitioners, For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules -against- THE STATE OF NEW YORK DIVISION OF HOUSING AND COMMUITY RENEWAL, ASSISTANT COMMISSIONER RICHMOND MCCURNIN and NORTHTOWN PHASE III ASSOCIATES, LP and NORTH TOWN PHASE III HOUSES, INC., Respondents.	Index No. 113635/09

REPLY MEMORANDUM OF LAW IN SUPPORT OF PETITIONER WESTVIEW TASKFORCE, INC.'S PETITION FOR A JUDGEMENT PURSUANT TO ARTICLE 78 OF THE CPLR

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TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page

CASES

STATUTES

OTHER AUTHORITIES

Petitioner Westview Taskforce, Inc. ("WTI" or "Petitioner") respectfully submits this reply memorandum of law in support of its petition for a judgment pursuant to Article 78 of the Civil Practice Law and Rules, asserted against the State of New York Division of Housing and Community Renewal ("DHCR"), Assistant Commissioner Richmond McCurnin, North Town Phase III Associates LP ("NTIII LP" or "Housing Company") and North Town Phase III Houses, Inc. ("NTIII Inc.") (hereinafter, NTIII LP and NTIII Inc. shall be referred to collectively as "NTIII").

PRELIMINARY STATEMENT

In answering the Petitioners' Verified Petition, DHCR reveals numerous errors in its interpretation of the governing law and its analysis of the relevant facts in this case. Those errors led DHCR to reach several arbitrary and capricious decisions with respect to NTIII's 2008 application for a rent increase order at Westview (the "2008 BRD"). These arbitrary and capricious decisions were directly responsible for DHCR conclusion, in its July 29, 2009 Rent Increase Order ("Rent Increase Order") that a 14.9% rent increase was appropriate at Westview. In fact, had DHCR merely adhered to the letter of the law with respect to the 2008 BRD, it would have concluded that no rent increase was necessary at Westview, and that it was required hold the individual owners and directors of the Housing Company ("Owners/Directors") personally liable for the $1,000,000 in damages their unlawful warehousing had caused Westview.

Specifically, DHCR erroneously concluded that second year budget for the 2008 BRD should include $163,800 for "Debt Service Arrears" payments. This decision violated the law in two specific ways. First, insofar as the funding occurred in the 2008 BRD's second year budget

cycle, such funding was prohibited by DHCR's own regulations. Second, in funding debt service arrears payments at all, DHCR also ran afoul of its own regulations as they specifically apply to Westview.

DHCR also made several arbitrary and capricious decisions with respect how it addressed – or failed to address – the warehousing of apartments that occurred at Westview from February 2004 until February 2, 2007. First, although DHCR had determined that warehousing had occurred pursuant to the instructions of NTIII, that the warehousing was unlawful, that the warehousing had cost Westview in excess of $1,000,000 in income, and that the warehousing, if not otherwise addressed, would lead to a rent increase. Nevertheless, DHCR completely disregarded the financial impact of the warehousing when it analyzed the 2008 BRD an arrived at its Rent Increase Order. Second, DHCR wrongly concluded that it had neither the authority nor the ability to recoup the lost $1,000,000, which NTIII's Owners/Directors deprived Westview exclusively for their own personal benefit. This conclusion fails to account for DHCR's express authority and obligation to have proceeded against the Owners/Directors pursuant to the Article II of the New York Private Housing Finance Law (the "Mitchell-Lama Law") as well as the claims and remedies that were available to DHCR at law. Third, DHCR acted arbitrarily and capriciously in concluding that it could not and should not proceed against the Owners/Directors because of WTI's *de minimus*, coerced acquiescence to the warehousing at Westview, which only occurred during the last 4 ½ months of the total 36 months it was in place.

Lastly, DHCR is continuing to act in an arbitrary and capricious manner by taking the position that it is unable to use new anti-warehousing regulations adopted by DHCR to recoup the $1,000,000 in lost rental income the Owners'/Directors' warehousing cost Westview. DHCR's conclusion is based upon a misunderstanding of law governing when new regulations

should be applied retroactively as well as its improper determination that DHCR should not seek the recoup the warehousing losses from the Owners/Directors because of WTI's *de minimus* acquiescence to the vacancies.

But for DHCR's arbitrary and capricious decisions with respect to the 2008 BRD, it would have concluded that no rent increase was necessary or required at Westview. This Court should remedy these egregious and enormously harmful errors by ordering DHCR to adhere strictly to the governing laws and regulations, to take all necessary steps to correct its errors including reversing its erroneous decision that a rent increase was required, and to take any and all available actions against NTIII's Owners/Directors to hold them personally liable for the results of the unlawful and self-serving warehousing they ordered at Westview.

ARGUMENT

I.

DHCR VIOLATED TWO PROVISIONS OF ITS OWN REGULATIONS BY FUNDING $163,800 OF DEBT SERVICE ARREARS PAYMENTS IN THE SECOND YEAR OF THE BUDGET CYCLE

DHCR acted arbitrarily and capriciously when it funded $163,800 in debt services arrears payment in the 2008 BRD's second budget year cycle, which violated 9 NYCRR §1728-1.5(h). In fact, DHCR's answering memorandum of law does not even mention this regulatory provision despite the fact that it is the only provision of DHCR's Mitchell-Lama regulations entirely devoted to the payment of debt service arrears.[1] The defenses DHCR does put forth with respect

[1] In fact, the regulation is mentioned only once in all of DHCR's papers, and only in referencing that it was cited by Petitioners. See Affidavit [of Richmond McCurnin] In Opposition to The Petition ("McCurnin Aff.") at ¶ 26.

to its inclusion of debt service arrears payments, although numerous and varied, do not establish grounds upon which the funding would have been permissible.

A. 9 NYCRR §1728-1.5(h) States That Debt Service Arrears May Only Be Funded In The First Year Of The Budget Cycle

The controlling law as to when debt service arrears can be funded within a Budget Rent Determination's ("BRD") two-year budget cycle is set forth in the first sentence of 9 NYCRR §1728-1.5(h), which states that "[d]ebt service arrears shall be funded in the first year of the budget cycle." (Emphasis added). Despite this exceedingly clear language, DHCR funded $163,800 in debt service arrears payments exclusively in the second year of the 2008 BRD budget cycle. See Affidavit of Marc B. Freedman, C.P.A., ¶11 ("Freedman Aff."). For whatever reason, DHCR appears insistent on funding a debt service arrears payment as part of the 2008 BRD – a curiosity insofar as NTIII did not even request debt service arrears funding, see Admin. R., A-2 at 7, and discussion, *infra*.

By the time DHCR issued the Rent Increase Order on July 29, 2009, the first year of the 2008 BRD budget cycle, which commenced July 1, 2008, had come and gone.[2] As such, the final 2008 BRD budget, and all the income and expense projections therein, only covers the second budget year.[3] See Admin. R.. A-38. Although DHCR falsely blames its delay in issuing the Rent Increase Order on the tenants, see Aff. of Richmond McCurnin in Opp'n to the Pet. ("McCurnin Aff.") at ¶ 27, the point is moot. §1728-1.5(h) contains no exception for funding debt service arrears in the case of a rent determination is delayed, regardless of who is at fault.

[2] Despite NTIII's and DHCR's doom and gloom projections for the first year of the budget cycle, see Admin. R., A-13 at 14 (NTIII projected a budget deficit of $2,788,996 for the first year budget cycle while DHCR projected a deficit of $2,624,000) , Westview's actual income and expenses for that year produced no deficit. See Freedman Aff. at ¶9

[3] The 2008 BRD's first budget year ran from July 1, 2009 to June 30, 2009; the second budget year runs from July 1, 2009 to June 30, 2010.

So while DHCR may attempt to instigate a debate over who is responsible for the 2008 BRD's delays, the uncontestable fact remains that the final 2008 BRD budget provides for debt service arrears payments exclusively in its second year, which is impermissible as a matter of law. On that ground, alone, this Court should order DHCR to revise its Rent Increase Order to eliminate the $163,800 in funding for debt service arrears and to reduce the rent increase accordingly.

B. 9 NYCRR §1728-1.5(h) Prohibits DHCR From Including Debt Service Arrears Payments In Westview's 2008 BRD

Regardless of the budget year in which they were funded, a larger problem for DHCR is that, with respect to Westview's 2008 BRD, funding debt service arrears payments is prohibited entirely. Again, the language of §1728-1.5(h) controls. Under the regulation, any amount of funds made available for arrears payments by DHCR must be "the lesser of: the total debt service arrears or an amount equal to the current debt service requirement, unless otherwise provided in an agreement restructuring the mortgage loan and approved by the commissioner." (Emphasis added). This provision balances two important BRD objectives. First, it protects affordability by keeping a Mitchell-Lama building's expenses as low as possible. This is accomplished by only permitting DHCR to fund the minimum amount of debt service payments that the housing company is required to pay. Second, the provision ensures a housing company receive the funding it needs to meet its minimum debt service arrears payment obligations. §1728-1.5(h) accomplishes these two objectives by stating that, subject to the other limitations set forth in the section, the amount of funds made available for arrears payments by DHCR must

be the lesser of (1) the total debt service arrears, or (2) the current debt service requirement, or (3) an alternative amount provided in a loan restructuring agreement.[4]

To determine the maximum amount of debt service arrears that can be funded under §1728-1.5(h), one needs to calculate each of these three figures and then identify which amount is the lowest. The first figure – the total debt service arrears at Westview – was $3,556,941 as of June 30, 2008. See Admin. R., A-13 at 2. The second figure – the current debt service requirement at Westview – is presently controlled by the terms of the Workout Agreement. As such, the second and third figures are identical. In order to determine the amount of the third figure, one needs to look to the language of the Workout Agreement.

The Workout Agreement clearly states that under the present circumstances, where income at Westview does not exceed expenses, debt services arrears payments are not required. See Verified Pet., Ex. G, Workout Agreement, at 17 ("Under the Workout Agreement, the Deferred Principal Arrears are required to be paid by the Housing Company provided, however, that if expenses in a particular year exceeded income, the Deferred Principal Arrears payments could themselves be further deferred." (emphasis added)), 18 ("Beginning February 1, 1997 through January 31, 2027 ('Maturity Date'), the housing company is required to make payments of principals and interest at 7.5% per annum on the Mortgage Payable-Deferred Principal Arrears, to the extent that there is Excess Project Cash . . . ." (emphasis added)). DHCR itself concedes that while debt service arrears payments may be made under the Workout Agreement,

[4] Contrary to the lengthy, red-herring arguments presented by DHCR and NTIII, Westview's loan restructuring agreement (the "Workout Agreement") is applicable to the 2008 BRD pursuant to the language of §1728-1.5(h) and not because the tenants are somehow trying to assert standing to enforce the agreement itself.

"the workout agreement does not require the payment of debt service arrears in either year of the budget cycle. . . ." McCurnin Aff. at ¶ 27 (emphasis in original).

The language of the Workout Agreement only permits the payment of debt service arrears out of an actual surplus, not a projected one. In other words, if there is money left over at the end of the year, under the terms of the Workout Agreement, it should be used to pay debt service arrears.[5] As such, this third figure is $0, because there is no year-end budget surplus at this time.[6]

Having ascertained that the lowest required debt services arrears payment for Westview is $0, per the terms of the Workout Agreement, the maximum allowable funding for debt service arrears under §1728-1.5(h) is $0.[7] Consequently, DHCR's inclusion of $163,800 for debt service arrears payments in the second year of the 2008 BRD budget, see Verified Pet., Ex. E at 5, was unlawful, regardless of the year it was provided.

C. DHCR'S NUMEROUS AND VARIED ATTEMPTS TO ESTABLISH THE LEGALITY OF ITS DEBT SERVICES ARREARS FUNDING ARE UNAVAILING

Lacking a single, valid justification for including debt service arrears payments in the second year of Westview's 2008 BRD budget, DHCR had chosen to pursue an everything-but-the-kitchen-sink defense to its failure to abide by 9 NYCRR §1728-1.5(h). None of the excuses set forth by DHCR, which are individually discussed below, are adequate as a matter of law.

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[5] In accordance with N.Y. Priv. Hous. Fin. Law §28(1), it appears Westview would need to show its actual income exceeded its actual expenses for a three year period before making debt services arrears payments.

[6] Even if a projected surplus allowed for the payment of debt service arrears, DHCR has not projected a surplus for the budget year commencing July 1, 2009. See Admin. R., A-38 at 2

[7] Again, if the budget projections are inaccurate and Westview has a budget surplus at the end of the year, debt service arrears could be paid out of that money, subject to other legal limitations.

As its first defense, DHCR points to N.Y. Priv. Hous. Fin. Law §28, which it claims establishes the propriety of including debt service arrears payment in the 2008 BRD's second budget year. See DHCR Memorandum of Law at 4. DHCR's decision to cite §28 in its defense while ignoring §1728-1.5(h) is odd because: (1) the section, which is titled "Payments From Earnings" is not even about arrears funding; it is about owners' dividends; and (2) the section only addresses arrears payments in the context of (a) treating them as a expense, "if, when and to the extent" they are paid, in calculating a budget that provides an owner's dividend, and (b) noting that if a project's income exceeds its expenses at the end of any three year period, debt payments can be made subject to DHCR's approval. DHCR's decision to refer this Court to a §28, which mentions debt service funding only in the most general of terms, while ignoring the debt service arrears provision of its own regulations, §1728-1.5(h), speaks for itself: DHCR knows that, under its own regulations, its inclusion of debt service arrears funding in the second budget year was unlawful.

DHCR's second defense relies on McCarthy v. New York State Div. of Hous. & Cmty. Renewal, 216 A.D.2d 4, 627 N.Y.S.2d 378 (1st Dept. 1995), which itself relies heavily on In re Arbor Hill Partners v. New York State Div. Hous. & Cmty. Renewal, 156 A.D.2d 896, 550 N.Y.S.2d 113 (3d Dept. 1999), for the proposition that DHCR has "[t]he authority to include a component for debt service arrears in the budgets of Mitchell-Lama housing companies." DHCR Memorandum of Law at 5. But these two cases only stand for the proposition that debt service arrears funding may, as a general matter, be included in a Mitchell-Lama's BRD expenses. Neither case mentions §1728-1.5(h), funding debt service arrears in the second budget year, or the existence of a controlling workout agreement. This is likely because each involved a general challenge to the inclusion or exclusion of funding for debt service arrears payments, and not, as

in the case at bar, a specific challenge to the year the funding was provided (in violation of the first sentence of §1728-1.5(h)) or to funding that exceed the amount permitted by DHCR's own regulation (in violation of the second and third sentences of §1728-1.5(h)).

Petitioners have never contested that, under the proper circumstances, DHCR may include debt service arrears payments in a Mitchell-Lama building's budget. Rather, Petitioners claim is that, with respect to our specific building and this specific BRD, DHCR was not authorized to do so and to raise tenants' rents to pay for them. The Court should not be distracted by such an obvious straw man argument.

For its third defense, DHCR claims that the first sentence of §1728-1.5(h), which states that "[d]ebt service arrears shall be funded in the first year of the budget cycle," leaves open the option to also fund debt service arrears in the second year. See McCurnin Aff. at ¶ 28.[8] Although the word "shall", when found in a statute, can have a mandatory and/or exclusionary function, see American Home Assurance Co. v. M.V. Jaami, 2007 U.S. Dist. LEXIS 25864 at *6-7 (S.D.N.Y. 2007), DHCR's interpretation of the word "shall" in 9 NYCRR §1728-1.5(h) incorrectly concludes it has a mandatory, but not exclusionary function.

As an initial matter, DHCR's mandatory-but-not-exclusionary interpretation of the word "shall" in §1728-1.5(h) has led them to incorrectly conclude that that "the regulation . . . require[s] payment of debt service arrears in the first year of the budget cycle." McCurnin Aff. at ¶ 28 (emphasis added). This position is undermined by the very next sentences of the provision, which states that "[t]he required funding shall be the lesser of: the total debt service

[8] It is only in this one small paragraph, which is buried in the Affidavit of Richmond McCurnin, that DHCR dares to discuss §1728-1.5(h). This lone attempt by DHCR to directly address §1728-1.5(h) so obviously misses the mark that DHCR omitted the argument from its memorandum of law entirely.

arrears or an amount equal to the current debt service requirement. . . ." 9 NYCRR §1728-1.5(h). It is obvious, in applying these next sentences, that if either the total debt service or the current debt service requirement equals $0, debt service arrears payments in the first budget year would not be mandatory, they would be prohibited. As such, DHCR's suggestion that the word "shall" means a payment must be made in the first budget year does not stand up to scrutiny.

Read in its entirety, §1728-1.5(h) makes clear that the word "shall" has a mandatory/exclusionary function; namely, that it provides that if DHCR is permitted to fund debt service arrears payments, and if DHCR want to provided for such funding, then DHCR must provide for it in the first year of the budget cycle or not at all. This reading, which accounts for the possibility that debt services arrears payments may or may not be allowed, is in accord with the full language of the provision, and it prohibits funding debt service arrears in the second budget year.

DHCR's position that §1728-1.5(h) does not prohibit funding debt services arrears payments exclusively in the second budget year is further undermined by its wild deviation from the plain meaning of the statute. When courts are called upon to determine the meaning of a statute or regulations, they should "begin with an examination of the [text's] plain meaning." Bluebird Partners L.P. v. First Fid. Bank, N.A., 97 N.Y.2d 456, 460, 767 N.E.2d 672, 674, 741 N.Y.S.2d 181, 183 (N.Y. 2002). Here the Court need not go any further than this initial examination, as the meaning of the language is abundantly clear. With respect to debt service arrears, the regulation states that "[d]ebt service arrears shall be funded in the first year of the budget cycle." 9 N.Y.C.R.R. §1728-1.5(h). Coupled with the fact that, under certain

circumstances, debt service arrears payment cannot be funded at all,[9] the language of §1728-1.5(h) could not be more plain.

The exclusionary nature of the word "shall" in §1728-1.5(h), which is contained in the phrase "shall be funded", can be analogized to contractual jurisdictional clauses that state lawsuits "shall be brought" in a particular court. See, e.g., American Home Assurance, 2007 U.S. Dist. LEXIS at *6-7 ("the language 'any action thereunder shall be brought' clearly excludes the possibility the suit can be brought in a forum [other than the one specifically identified in the contract]." (emphasis added)); Korean Press Agency v. Yonhap News Agency, 421 F. Supp.2d 775, 779 (S.D.N.Y. 2006) ("The phrase 'shall be under' is singular and imperative." (emphasis added)). In a contractual context involving jurisdiction, as in the statutory one here, the "shall be [operative verb] in [specific singular noun]" linguistic construct plainly indicates that the word "shall" was intended to exclude all other alternatives.

DHCR fourth defense argues that, because arrears had been previous funded at the same level, they were not responsible for the rent increase and, in any event, debt service arrears are paid only after all other expenses of the housing company are paid.[10] See McCurnin Aff. at ¶ 22. This argument is patently absurd. The rents at Westview are established by DHCR based on its singular obligation to ensure that the building's income meets its cumulative expenses. Any item that increases Westview's expenses, regardless of whether that item was new or existed in

[9] Such as in the case at bar. See Part I.B., *supra*.

[10] DHCR even goes so far as to claim these are "the two most important facts about the inclusion of funding of debt service arrears." McCurnin Aff. at ¶ 22; See also DHCR Mem. of Law at 5. DHCR's claim is at least consistent with, and somewhat helps to explain, its arbitrary and capricious decision to include debt service arrears funding in the 2008 BRD's second budget year. What DHCR should have recognized was the most important fact with respect to arrears funding is that funding of Westview's debt service arrears at all, let alone in the second budget year, violates its own regulations. See 9 N.Y.C.R.R. §1728-1.5(h); Parts I.A., I.B., *supra*.

previous budgets,[11] creates the need for more income to be generated. When an included expense is improper, the demand for additional income to cover that expense is likewise improper. Such is the case here. See Freedman Aff. ¶12. Further, DHCR's statement that the unlawfully included expense will only be paid if all other expenses are paid first is of no consequence. The funding of debt service arrears violated the law at the time DHCR included it in the 2008 BRD's budget; the illegality does not attach only if and when the improper expense is paid.

DHCR fifth defense makes the odd claim that DHCR should be given some sort of leniency with respect to arrears funding because its budget did not an equity payment to NTIII LP's partners. See DHCR Mem. of Law at 5. This is a peculiar argument on two fronts. First, DHCR did not include a payment of equity to NTIII LP's partners because it is expressly prohibited from doing so under the terms of the Workout Agreement. See Verified Pet., Ex. G, Workout Agreement, at 20 ("Distribution of Housing Company income to the partners in the Partnership are subject to the approval of DHCR and can only be made provided that the Housing Company is current on all of its debt service and OEF payments." (emphasis added)). Because the Housing Company is not current on all of its debt service, the payment of equity to the partners was prohibited. Further, even if, *arguendo*, DHCR was allowed to fund equity payments to NTIII LP's partners, DHCR's argument is essentially this: because DHCR did not fund an item it was allowed to fund, this Court should allow it to fund an item it is prohibited from funding. This argument is preposterous and lacks any foundation in the law.

[11] Simply because the inclusion of an expense item was proper in a past budget does not establish that its inclusion will be proper in future budgets.

In its sixth defense, DHCR makes a similarly bizarre claim, albeit half-heartedly in only one sentence of Richmond McCurnin's affidavit; namely, that DHCR, in setting rents, is allowed to overcharge tenants so as to generate a level of income that exceeds expenses and creates a profit for the Housing Company.[12] Mr. McCurnin claims that because DHCR did this in our case, those profits enabled DHCR to fund debt service arrears payments. McCurnin Aff. ¶12. This statement is blatantly false and is designed to mislead the Court and cover up DHCR's erroneous inclusion of debt service arrears payments. In his own order increasing rents at Westview, Mr. McCurnin wrote as follows:

> NOW, on considering the entire record from which it appears . . . there have been and will be substantial increases in the cost of operating the development, including but not limited to, the increase cost of maintenance and operating expenses, and that the present maximum average rentals are insufficient to meet such increases in costs and to make other necessary and authorized expenditures. I . . . FIND AND DETERMINE that the minimum increase in the maximum average monthly room rentals necessary to enable the said applicant to make the payments required to be made is $51.32. The increase authorized herein is not in excess of the minimum amount necessary to enable the housing company to make payments required to be made by the provisions of the Private Housing Finance law.

Admin. R., A-38 at 2 (emphasis added). See also Admin. R., A-38 at 4 (showing that under DHCR's final 2008 BRD projections, Westview's projected deficit of "[$]2,734,000" was

[12] This argument is completely inaccurate. To insure rents are kept low in Mitchell-Lama buildings, rents are set at an amount where income equals expenses, plus a 6% return on equity to the partners where it is otherwise permitted. See, e.g., In re Eastwood Bldg. Comm. of Roosevelt Island v. Eimicke, 140 A.D.2d 425, 426, 515 N.Y.S.2d 466, 467 (1st Dept. 1987) ("The challenged order clearly sets forth a factual basis for the agency determination. It specifically states that the DHCR had found that the project's operating expenses had increased,. . . that the current rental rates would be insufficient to meet those expenses and that, therefore, a rent increase would be necessary."(emphasis added)). If DHCR was not limited to increasing rents to meet expenses, but instead could create a surplus for the housing company (of 15%? 50%? 150%?) whenever it felt moved to do so, it would undermine the entire Mitchell-Lama program and make a mockery of the BRD process.

reduced to "[$]0" for the budget year ending June 30, 2010 – which is a balanced budget, not one with a surplus). Clearly the Rent Increase Order was not intended to produce a surplus.

Even if Mr. McCurnin's claim about budgeting for a surplus was true, the Workout Agreement states that debt services arrears payment are required be made unless "expenses in a particular year exceeded income." Verified Pet., Ex. G, Workout Agreement, at 17 (emphasis added). It further states that Arrears can only be paid "to the extent that there is Excess Project Cash." Id. at 18 (emphasis added). The term "exceeded" in the first phrase is a past-tense verb, and the term "is" is a present-tense verb. These words, both individually and collectively, establish that debt service arrears can be paid only if an actual surplus exists, not, as a future-tense verb would suggest, if a surplus is merely projected. Thus, pursuant to the terms of the Workout Agreement, if at the end of a given year Westview's actual income exceeds its actual expenses, then NTIII would be obligated to use that extra income to pay debt service arrears.[13]

In any event, the 2008 BRD budget for Westview, upon which the current rent increase was based, does not collect rents "in excess of the minimum" necessary to meet expenses and, accordingly, projects a budget surplus of $0.

DHCR seventh defense, which was asserted by its attorney, Sheldon Melnitsky in a conference before this Court on October, 2, 2009, is that DHCR's regulations presently merely guidelines that DHCR can stray from whenever it sees fit.[14] This is not the case. "It has long been settled that an agency's regulations promulgated pursuant to statutory authority are binding

[13] But see N.Y. Priv. Hous. Fin. Law §28(1) (stating that a surplus must be produced over the course of three years in order to use that money to pay the Housing Company's debts).
[14] The fact that DHCR presented a "we do not have to follow our own rules" defense in this case is all but a *de facto* admission they violated them.

upon the agency itself as well as others." In re Eastwood Building Committee, 118 Misc.2d at 495, 461 N.Y.S.2d at 185 (emphasis added).

Despite Mr. Melnitsky's statement to the contrary, DHCR's own regulations reflect its clear understanding that if DHCR wants the ability to deviate from its own regulations, it must expressly reserve that right in its regulations. See 9 NYCRR §1728-1.1(c) ("Where necessary to carry out the policy of the Private Housing Finance Law and the policies of the Division of Housing and Community Renewal, the commissioner may modify any provision of this section or section 1728-1.2 of the Subpart." (emphasis added)). No such reservations were made with respect to 9 NYCRR §1728-1.5, which contains the rules governing debt service arrears funding.

DHCR's eighth and last defense to its debt service arrears funding somewhat concedes that the Workout Agreement governs arrears funding under the circumstance presented here.[15] The defense is that "Petitioners have no standing to invoke the provisions of the workout agreement." DHCR Mem. of Law at 6. Although Petitioners believe Westview's tenants are a third-party beneficiary of the Workout Agreement, ultimately whether Petitioners have standing to assert a claim under the Workout Agreement is completely irrelevant. This is the case because Petitioners are asserting that DHCR failed to follow its obligations under 9 NYCRR § 1728-1.5(h), which incorporates the Workout Agreement's requirements by reference. Surely DHCR is not challenging Petitioners' standing to enforce the Mitchell-Lama law and its regulations.

Simply put, by including $163,800 in funding for debt service arrears payments in the second year of Westview budget, which was neither permitted by law nor even sought by NTIII

[15] If the language of the Workout Agreement was not adverse to DHCR's position, it would be unimportant whether Petitioners could legally enforce it, and DHCR would not be making the argument.

in its application for a rent increase, violated DHCR own rules governing the funding of debt arrears payment. As such, the only "standing" issue in this case is that, despite asserting eight separate defenses to its failure to abide by§1728-1.5(h), DHCR still does not have a leg to stand on.

D. DHCR'S DECISION TO INCLUDE DEBT SERVICE ARREARS FUNDING IN THE 2008 BRD BUDGET RAISES SOME SIGNIFICANT CONCERNS REGARDING DHCR'S MOTIVES

It is impossible to complete a discussion of DHCR's debt service arrears funding without taking note of two very curious aspects of its decision to include them in the 2008 BRD Budget.

The first such curiosity stems from the fact that NTIII did not even ask for arrears funding when they initiated the 2008 BRD and set forth all the future expenses they wanted DHCR to consider.[16] See Admin. R., A-2 at 7. Nevertheless, DHCR passed on the opportunity to help control Westview's rents and budgeted an astounding $1,641,000 for debt arrears payments anyway. See McCurnin Aff. at ¶ 23; Verified Pet., Ex. E at 5. DHCR stated that it chose this amount because it believed it was "the maximum permitted by the Regulations." See Admin. R., A-13 at 11, 26.

[16] David Hirschhorn, the current president of both NTIII LP and NTIII Inc., suggests in his Affidavit that NTIII did request debt service arrears funding by stating that the figure was included in NTIII's rent increase application. See Reply Affirmation of David B. Hirschhorn ("Hirschhorn Aff.") ¶42. This is a blatant attempt to mislead the Court. The Court needs only to look at line 90 of the proposed budget that accompanied NTIII's rent increase application, which is entitled "Debt Service – Arrears," to see that, under that heading, the amount for "Actual Per Certified Annual report FYE" is $0, the amount for "Projections, Budget Year 1" is $0, and the amount for "Projections, Budget Year 2" is $0. Admin. R., A-1 at 9. Mr. Hirschhorn also states that "the current annual debt service arrears payments due and payable by the Housing Company" is $163,800. Again this is not true, and one needs only to look at NTIII's Workout Agreement to confirm the inaccuracy of that statement. See Ex. G, Workout Agreement, at 17, 18; Part I.B, *supra*. Unlike Mr. Hirschhorn, the facts do not lie.

Although the final amount was reduced to $163,800,[17] see McCurnin Aff. at ¶ 23; Admin. R., A-38 at 7, Verified Pet., Ex. E at 5, the arrears payment still constitutes a $163,800 expense the Housing Company did not seek in its rent increase application but nevertheless received from DHCR. This unlawful act by DHCR served to drive up Westview's projected expenses and, as a result, the amount of the rent increase they ordered. It is hard to imagine why DHCR would pursue such a course of action unless the result they achieved was one they were specifically pursuing.

The second curiosity involves DHCR's continuing pattern of funding debt service arrears essentially as a phantom expense that inflates the income Westview's tenants need to generate through their rents. Although DHCR claims it has included funding for debt service arrears payments in past budgets, see McCurnin Aff. ¶22; DHCR Memorandum of Law at 5 – an expense tenants' rents paid for – the Workout Agreement states that no such payments have ever been made. See Verified Pet., Ex. G at 22 ("As of December 31, 2008, no portion of the Deferred Principal Arrears had been paid. . . .).

This presents DHCR's decision to fund debt service arrears as part of the 2008 BRD in a very troubling light, especially in light of the fact that NTIII dared not request such funding. Why would DHCR include an expense item it knows has been funded in the past but never paid? DHCR's extraordinary behavior with respect to funding debt service arrears raises serious questions about DHCR's motives and intentions in evaluating and deciding the 2008 BRD.

[17] DHCR actually pats itself on the back for reducing the amount it originally budgeted for debt service arrears payments by $1,403,000. See DHCR Mem. of Law at 12. Contrary to what DHCR may think, reducing an unlawful and unrequested debt service arrears payment from a astronomically high figure to a lower, but similarly unlawful and unrequested amount is not a laudable accomplishment.

It very much appears that DHCR's decision to include this $163,800 phantom expense was nothing more than an attempt to inflate Westview's expenses so DHCR could justify a higher rent increase at Westview. At first blush, this may seem like an incredible conclusion to draw. However, once one understands that WTI, NTIII and DHCR all knew that NTIII absolutely needed a rent increase of 15% to qualify for bank financing to pay off the building's present mortgage – a prerequisite to removing the building from the Mitchell-Lama program, see N.Y. Priv. Hous. Fin. Law §35(1) – it makes considerably more sense.

DHCR has repeatedly stated, and has played an active role in facilitating, Westview's removal from the Mitchell-Lama program under an agreement that preserves affordability. Such a result, which would take Westview off DHCR's hands (not a small consideration for DHCR in light of enormous amount of its time and effort Westview has taken up over the past several years), can only be accomplished if NTIII qualifies for bank financing to pay off its present mortgage. To qualify, DHCR had to provide NTIII with a 15% rent increase.

The necessity of the 15% rent increase is confirmed by emails between Opher Pail, Co-Chair of WTI and David Hirschhorn, President of NTIII. On February 4, 2009 at 3:39 p.m., Mr. Pail wrote to Mr. Hirschhorn to ask "[I]s there any bottom line rent adjustment that you must get to qualify for bank financing?" Mr. Hirschhorn responded at 6:46 p.m., writing that they needed "Essentially what was in the [October 24, 2008] proposal." See email exchange between Opher Pail <opherp@gmail.com> and David Hirschhorn <dbhirsch@optonine.net>, Feb. 4, 2009, a true and correct copy of which is attached as Exhibit A. This email exchange occurred more than almost six months prior to the date DHCR issued its rent increase order. See Admin. R., A-38.

The proposal referenced by Mr. Hirschhorn was an October 24, 2008 document, prepared by NTIII, entitled "A Plan For The Withdrawal of Westview Houses From Mitchell Lama" ("October 2008 Proposal"). The October 2008 Proposal includes implementing "A new initial 'Base Rent' for each apartment [that] will be set at the time of the Master Closing." See October 2008 Proposal at 4, a true and correct copy of which is attached hereto as Exhibit B. The proposal calls for a 12% across-the-board rent increase at Westview plus an additional rent "surcharge" that varies depending on the incomes of individual tenants. Id. at 4-5. The additional rent surcharge, at its lowest, is "equal to the then 1 year RGB[18] increase," id., which has generally been 3% since October 2007. See <http://www.housingnyc.com/html/guidelines/orders/order39.html> (allowing a 3% rent increase from October 1, 2007 to September 30, 2008); <http://www.housingnyc.com/html/guidelines/orders/order40.html> (allowing a 4.5% rent increase from October 1, 2008 to September 30, 2009); <http://www.housingnyc.com/html/guidelines/orders/order41.html> (allowing a 3% rent increase from October 1, 2009 to September 30, 2010). As such, the formula for the minimum rent increase provided for in the October 2008 Proposal, and needed by NTIII to qualify for bank financing, is 12% + RGB 3% = 15%.

So in the final analysis, NTIII needed a rent increase of 15%[19] and DHCR provided them a rent increase of 14.9%. How fortuitous.[20]

[18] Rent Guidelines Board.
[19] It is important to note that this 15% rent increase was not needed to cover an operating deficit, which is the only permissible grounds for granting a rent increase, but rather was needed to secure bank financing.

II.

DHCR ACTED ARBITRARILY AND CAPRICIOUSLY IN FAILING TO ACCOUNT FOR THE $1,000,000 WESTVIEW LOST TO UNLAWFUL WAREHOUSING AND BY DISREGARDING ITS LEGAL OBLIGATION TO RECOUP THOSE LOSSES FROM NTIII'S OWNERS AND DIRECTORS

A discussion about DHCR's failure to account for the $1,000,000[21] in income Westview lost as a result of NTIII's Owners'/Directors' decision to warehouse apartments exclusively for their personal benefit must commence with the presentation of a few undisputed facts.

A. THE WAREHOUSING THAT OCCURRED AT WESTVIEW FROM FEBRUARY 2004 TO FEBRUARY 2, 2007 WAS INSTITUTED BY THE OWNERS/DIRECTORS, SOLELY FOR THEIR OWN BENEFIT, AND COST WESTVIEW OVER $1,000,000 IN INCOME

First, it is indisputable that the practice of warehousing apartments at Westview began in February 2004, see Verified Pet., Ex. I at 50 ("In February 2004, a private entity[22] signed a contract to purchase Westview. . . . Shortly after the agreement . . . was reached, the number of vacancies began to rise."), and continued until DHCR ordered the Housing Company to cease the unlawful practice on February 2, 2007. See Letter from DHCR Deputy Commissioner David

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[20] It is hard not to conclude that some form of "reverse engineering" on the part of DHCR was at play here. This means that instead of projecting Westview's income and expenses and seeing if the figures justified a rent increase, DHCR first determined the precise rent increase that NTIII needed and then manufactured income and expenses projections that would justify such a rent increase. This smoke-and-mirrors routine was necessary because DHCR is not allowed to grant a rent increase based on a housing company's desire to secure a loan. The fact that DHCR's rent increase so precisely matched the one NTIII's needed raises a giant red flag that is not easily ignored.

[21] David Hirschhorn argues that Petitioners' $1,000,000 valuation of the warehousing losses presents a "very large and very round number." See Hirschhorn Aff. ¶ 22. He is correct in both regards. First, he is correct that the amount of money lost by Westview as a result of NTIII's unlawful warehousing was very large. Second, he is correct that $1,000,000 is a rounded number. For simplicity's sake, WTI has regularly referred to the warehousing losses as being $1,000,000. In fact, WTI's accountant, Marc Freedman, C.P.A. calculated the losses due to warehousing to be $1,036,364. See Freedman Aff. ¶14. Going forward, Petitioners will continue to generally refer to the losses as being $1,000,000; however, where precision is called for, the $1,036,364 figure will be used.

[22] The Sheldrake Organization, Inc. a/d/b/a R.I. Westview LLC ("Sheldrake").

Cabrera to former- NTIII president Charles A. Lucido, Esq. et al., dated February 2, 2007 (the "Cabrera Warehousing Letter"), a true and correct copy of which is attached hereto as Exhibit C. A near universal consensus exists that the warehousing of apartments at Westview lasted for a period of three years. See Verified Pet. at ¶26-28 (statement on warehousing by Petitioners); Ex C at 1 (statement on warehousing by respondent-DHCR); Verified Pet., Ex. I at 50 (statement on warehousing by New York State Inspector General). According the New York State Inspector General, prior to February 2004, Westview "had, at most, three to five vacant units at a time. However, by November 2005, the number of vacancies had risen to 27, or a rate of 7.5 percent." Verified Pet., Ex. I at 50. DHCR reported that the number of vacancies continued to climb, and by May 2007, the vacancy rate at Westview reached a staggering 9.1% – nearly one in every ten apartments. See Admin. R., A-13 at 6.

Only NTIII has the audacity to claim that warehousing never occurred at Westview.[23] See NTIII Mem. of Law in Opp'n at 15 ("In fact there was no 'illegal warehousing'"); Hirschhorn Aff. at ¶ 19 ("In fact, NTIII did not illegally warehouse apartments."). Not only does this blatantly false statement run contrary to clear, indisputable facts and the conclusions of Westview's tenants, NTIII's fellow respondent, DHCR, and the New York State Inspector General, it is even belied by the NTIII's own sales agreement with Sheldrake.

Specifically, the Amendment No. 1 To Sale-Purchase Agreement, dated November 30, 2004, explicitly provides that, regardless of whether the sale of Westview is culminated or not,

[23] Despite his denial that warehousing occurred, David Hirschhorn, also makes the baseless and self-serving claim that the "apartments [being] held off the market and not rented" (a.k.a. warehousing) did not start until "early 2006" when it was done at the tenants' request. See Hirschhorn Aff. at ¶ 19. Ironically, in the same paragraph Mr. Hirschhorn denies the existence of warehousing, he asserts the Petitioners have a "proclivity for deception and bait and switch tactics." Id.

NTIII's Owners/Directors would personally profit from the warehousing at Westview. See Amendment No. 1 To Sale-Purchase Agreement, November 30, 2004 ("Sales-Purchase Agreement Amendment"), at 2-3, a true and correct copy of which is attached hereto as Exhibit D ("In the event that Purchaser fails to obtain the Required Contracts . . . and the Purchase Agreement is terminated, then the Purchaser shall pay to the Sellers fifty percent (50%) of the rent that would have been collected or collectible on and after the Start Date to and including the date of such termination from any apartment that is vacant on or after the State date, but only for the duration of such vacancy, and except to the extent of vacancy losses incurred in the ordinary course of business to the extent that [the managing agent] Blackwell is preparing said apartment to the rented or awaiting any diligently-pursued approval by DHCR of a prospective tenant of said apartment.").[24] The Sales-Purchase Agreement Amendment clearly and undeniably creates an agreement between NTIII's Owners/Directors and potential-purchaser Sheldrake that NTIII's Owners/Directors would receive a payment from Sheldrake equal to half of warehousing losses (which ultimately proved to be over $500,000), which the Sales-Purchase Agreement Amendment identifies as vacancies that were not "incurred in the ordinary course of business."

Finally, although Petitioners do not have copies of the referenced documents, on December 12, 2006 then-DHCR Commissioner Judith A. Calogero wrote to NTIII that "[a]ccording to correspondence, copies of which have been made available to DHCR, it was the policy of [NTIII] not to lease vacant apartments pending a sale of the properties and conversion

[24] This is actually a modified version of a similar clause provision the original Sales-Purchase Agreement, see Ex. F at 14, except that the terms in the Sales-Purchase Agreement Amendment are expanded and far more favorable to NTIII.

to condominium ownership."[25] See Letter from DHCR Commissioner Judith A. Calogero to Charles A. Lucido, Esq. et al., dated December 12, 2006, ("Calogero Warehousing Letter"), a true and correct copy of which is attached hereto as Exhibit E.

Second, it is essentially undisputed that the warehousing cost Westview at least $1,000,000 in income. WTI's accountant, Marc Freedman, was the first person to calculate the precise losses due to the Owners'/Directors' unlawful warehousing. He arrived at a figure of $1,036,364 and first presented it to DHCR in August 2008 as part of his 2008 BRD submissions for WTI. See Freedman Aff. at ¶14; Admin. R., A-17 at 4, 8. Later, during the pendency of the 2008 BRD, DHCR undertook its own effort to calculate Westview's warehousing losses. According to an internal DHCR document entitled "Westview, Calculation of Revenue Loss Due to 'Warehousing' Assuming A Vacancy Rate of 0.8%", DHCR calculated that the income lost to warehousing at Westview was $1,065,777. See Admin. R., A-15 at 1.[26] The difference between Mr. Freedman's and DHCR loss calculations is a miniscule $29,413.

NTIII does not seriously challenge this figure; rather, it (1) falsely claims warehousing did not occur at Westview, (2) makes the outrageous claim that, in any event, warehousing is not

[25] Throughout the BRD process, and carrying over into this case with respect to, *inter alia*, denying warehousing occurred, NTIII has shown a repeated willingness to misrepresent the truth in order to secure its rent increase. That this pattern continues here is not surprising and should put the Court on notice that NTIII's credibility, as well as that of its Owners/Directors, is suspect.

[26] This critical document, and the entire Administrative Record, was originally withheld from the Petitioners despite being submitted to the Court along with DHCR's opposition papers. It was only after WTI's attorneys discovered the omission and requested a full and complete copy of all the papers DHCR submitted to the Court that a copy of the Administrative Record was provided.

illegal,[27] Hirschhorn Aff ¶19 n. 3, and (3) pejoratively states that Westview's accountant "concocted" the figure, NTIII Mem. of Law at 15, and "plucked [it] out of thin air," Hirschhorn Aff. ¶22, a difficult statement to back up in light of the fact that DHCR's independent calculation vary from those of WTI's accountant by a scant 2.76%. Compare Freedman Aff. ¶14 with Admin. R., A-15 at 1. NTIII has never offered an alternative calculation of the warehousing losses.

Third, it is beyond dispute that the warehousing was instituted to increase the value of the Westview in a sale of the building from NTIII to Sheldrake. Such is the conclusion of the wholly independent and otherwise disinterested New York State Inspector General, Kristine Hamann. See Verified Pet., Ex. I at 49-50 (concluding that warehousing began at Westview only after NTIII reached a sales agreement with Sheldrake and explaining that "[t]he law permits housing companies to 'buy out' of the Mitchell-Lama program after a certain period of time if the mortgage is fully paid. A buyout can present the owner with substantial profits, since vacant apartments may be sold or rented at market prices once the development leaves the program. Housing companies may not receive the same windfall from occupied apartment. . . . Thus, where a buyout is imminent, the housing company may 'warehouse' apartments by holding them off the market."). See also Ex. E at 1. Of course, Petitioners wholly agree with the Inspector General's analysis.

[27] DHCR strongly and rightfully disagrees with this assertion. See Ex. E at 2 ("[W]hile DHCR regulations do not deal specifically with warehousing, managing agents are required by the regulations to operate in accord with DHCR regulations governing marketing, maintenance of waiting lists, selection of applicants, and the prompt restoration of vacated apartment – all of which by implication require a regularized process for rental of vacant apartment. . . . therefore [warehousing is] considered a violation of DHCR regulations.").

Fourth and finally, it is well-established in the record that WTI asked DHCR repeatedly during the course of the 2008 BRD process how it was going to address the issue of the $1,000,000 lost to warehousing and DHCR repeatedly refused to respond. The tenants even threatened a rent strike just to get DHCR to answer the question but DHCR remained silent. See Admin. R., A-19 at 6-8; A-21 at 4, 6; A-22 at 6; A-29 at 1; A-34 at 12-13.

B. BOTH IN ACCORDANCE WITH MITCHELL-LAMA LAW AND PRINCIPLES OF EQUITY, DHCR WAS OBLIGATED TO PURSUE LEGAL ACTION AGAINST NTIII'S OWNERS AND DIRECTORS TO RECOUP THE $1,000,000 IN WAREHOUSING LOSSES

As discussed *supra*, during the 2008 BRD, WTI asked DHCR on at least five separate occasions how they intended to account for the $1,000,000 Westview lost to the Owners'/Directors/ unlawful warehousing, but DHCR repeatedly refused to answer. It is important to note that DHCR did not provide WTI with an incomplete or unsatisfactory answer, it completely declined to respond. It appears DHCR steadfastly refused to respond because it was determined not to hold the Owners/Directors accountable for the loss but at the same time realized that they had no legitimate grounds upon which to base and defend their decision. In fact, the Calogero Warehousing Letter specifically laid out the undeniable link between a housing company's warehousing and the need to raise tenants' rents. Ms. Calogero wrote that DHCR,

> [P]repares a budget for a two year cycle, based upon projections of the housing company's costs over the next two years. Once a cost structure is determined, the rents are set at a level designed to produce sufficient revenue to enable the housing company to meet all its expected expenses. Obviously, if a significant number of apartments remain vacant, the rent will have to be set at a higher level than otherwise, burdening the tenants in the occupied apartments with higher rents.

Ex. E at 1-2 (emphasis added).

Like an ostrich burying it head in the sand, DHCR was hoping if it ignored the tenants long enough, the warehousing issue would go away because the tenants would not dare sue DHCR, even if doing so was necessary to avoid being forced to pay for $1,000,000 in warehousing losses the tenants neither caused nor benefitted from. DHCR was wrong.

1. DHCR's "No Authority, No Ability" Position With Respect To Holding Persons Liable For Violating Anti-Warehousing Laws Invites Unlawful Conduct And Runs Afoul Of Court Rulings Admonishing DHCR For Adopting Such Positions

Now, finally forced to address the warehousing losses issue in this lawsuit, DHCR's best defense was that it simply lacks the authority and ability to recoup the lost revenue. DHCR Mem. of Law at 6-7. Petitioners finds this defense troubling not only because it lacks any basis in law, [28] but also because if DHCR had made this "no authority, no ability" position clear to WTI before ordering the rent increase, we could have explained how DHCR could (and in fact was required to) proceed against NTIII's Owners/Directors to recoup the rental income lost to warehousing. Such course of action would have dramatically reduced the current rent increase, if not eliminated it entirely, and very likely eliminated the need for the present lawsuit.

Although DHCR's position is troubling as it applies to this action, its implications are even more disconcerting when applied to the Mitchell-Lama program in general.

When warehousing occurs, it causes two specific harms: First, it removes affordable housing units from the pool of affordable housing. Second, it deprives a Mitchell-Lama building

[28] DHCR seems to have a surprisingly weak grasp of Mitchell-Lama law and its own regulations. This has been made clear not only by, *inter alia*, DHCR's "no authority, no ability" warehousing defense, but also by its need to submit a supplemental answer in this case. DHCR's supplemental answer was required because, when DHCR submitted its initial answer along with Richmond McCurnin's affidavit, neither its lawyers nor Mr. McCurnin, who is DHCR's Assistant Commissioner in charge of overseeing the Mitchell-Lama program, knew DHCR had adopted new Mitchell-Lama regulations that addressed warehousing issues.

of income, which in turn threatens affordability because, ultimately, any significant loss of income will lead a housing company to seek a rent increase from the tenants to make up the shortfall, just as NTIII did here. See Ex. E at 1. With respect to the warehousing at Westview, DHCR remedied the first problem by ordering Westview's Housing Company to fill the existing vacancies on February 2, 2007. See Ex. C. But with respect to the second problem – the loss of income to the housing company – DHCR's position is that when it discovered NTIII's Owners/Directors had unlawfully ordered the warehousing of Westview apartments for their personal financial benefit, it had no power to do anything about it. According to DHCR, warehousing, although unlawful, was subject only to a cease and desist order – Westview's Owners/Directors could never be held financially responsible for the $1,000,000 in warehousing losses or for the improper profits they secured as a result of their unlawful conduct.

The broader implications of this position on the Mitchell-Lama program are conscious-shocking. According to DHCR, prior to the time this action was commenced, Mitchell Lama owners had a green-light to attempt to personally profit by violating anti-warehousing laws and regulations. This was the case because, under DHCR's misguided view of the law and rules, the only action DHCR could take against Mitchell-Lama owners for unlawful warehousing was to order them to stop. As for the damages the owners' warehousing caused to the building and its tenants, much to the owners' delight, DHCR's position was that they could not be held liable for the lost income. Finally, the invitation for owners to break anti-warehousing laws was made complete by DHCR's position that such losses could not be accounted for in a future BRD, even if the owners sought to recoup the lost income from their own tenants. DHCR's position is dangerous and lacks common sense because it invites Mitchell-Lama owners to break the law

without fear of consequences. More importantly, the position is wrong as a matter of law. It is simply astonishing that DHCR would choose to paint itself as such an impotent agency.

DHCR has been admonished by New York courts on multiple occasions for taking positions that undermine or invite the abuse of the laws it is charged with administering. As such, it should have known better than to take such a position here.

For example, In re Classic Realty LLC v. New York State Div. of Hous. & Cmty. Renewal, 2 N.Y. 3d 142, 808 N.E.2d 1260, 777 N.Y.S.2d 1 (N.Y. 2004), involved tenants who faced the deregulation of their rent stabilized apartment because its rent exceeded $2,000 per month and their joint income for the past two year exceeded $175,000 on their annual tax returns. After receiving an adverse decision, the tenants submitted a new, amended tax return to DHCR that brought their income below the deregulation limits. Despite the owner's protestations, DHCR did not inquire as to why the tenants suddenly decided to amend their tax return. Instead, it just accepted the new return, effectuating what the court labeled a "do-over". The Court of Appeals held that DHCR's acceptance of the amended return with no showing of special circumstances, "cannot stand as it invites abuse of the luxury decontrol procedures," Id., 2 N.Y. 3d at 46, 808 N.E.2d at 1262, 777 N.Y.S.2d at 3 (emphasis added). Accord In re Grimm v. New York State Div. of Hous. & Cmty. Renewal, 2009 Slip Op 6653 at *4, 886 N.Y.S.2d 111, 114 (1st Dept, Sept. 24, 2009), (disapproving of a DHCR decision to allow a landlord who overcharged rents to escape DHCR action based on an administrative loophole, and stating "to be sure, if DHCR is permitted to turn a blind eye to a situation such as this . . . the protections afforded by the Rent Stabilization Law can be subverted to the detriment of those in need of affordable housing." (emphasis added)).

The same circumstances exist here. If DHCR is permitted to maintain its current position that, although warehousing is unlawful, it has no recourse to recoup a building's unlawfully deprived income, then it is adopting yet another position that "invites abuse" of the anti-warehousing rules and allows "the protections afforded by the [Mitchell-Lama] Law [to] be subverted to the detriment of those in need of affordable housing." This is the ultimate example of an agency decision being arbitrary and capricious.

2. DHCR's "No Authority, No Ability" Position Impermissibly Creates A "Right Without A Remedy" Within The Mitchell-Lama Law

The aforementioned rulings of the Court of Appeals and First Department are consistent with the legal maxim that "there is no right without a remedy." Here, the "right" under the Mitchell-Lama law can be expressed in two ways. First, it can be expressed as a right held by the State of New York (and DHCR as its administrative agency); namely, that New York State has a right to receive a full and complete return on its investment in Westview, in terms of the number of affordable housing units it created, by providing NTIII with tax breaks and low interest loans under the Mitchell-Lama program. See generally New York State Mortgage Loan Enforcement & Admin. Corp. v. Arbor Hill Houses Inc., 180 A.D.2d 926, 927, 580 N.Y.S. 538, 539 (3d Dept. 1992). At its peak, the warehousing at Westview deprived the state of the proper use of nearly 10% of the building's apartments, which were intentionally held vacant. See Admin. R., A-13 at 6. DHCR's position that it has no means, in law or in equity, to hold persons financially responsible for unlawfully warehousing apartments leaves New York State with a right but no remedy under the Mitchell-Lama law.

Second, the right devoid of a remedy can be expressed as one collective held by a building's tenants; to wit, in return for paying their rents, which are collectively set by DHCR at

a level that is sufficient to meet their building's expenses, tenants receive numerous rights vis-à-vis their housing company, including, *inter alia*, that (1) their rents will be used for their various intended and assigned purposes, per the BRD process, (2) their building will be well kept and maintained, and (3) their rents will be kept as low as possible by having all of their building's apartments used to generate income to pay the building's expenses. The warehousing at Westview not only deprived the building of income it needed to meet its expenses, but the tenants are now being required to make up for the shortfall in income that occurred because only 90% of the building's units were used to generate income rather than 100%. See Ex. E at 1-2. DHCR's position that it has no means, in law or in equity, to hold persons financially responsible for unlawfully warehousing apartments leaves Mitchell-Lama tenants with a right but no remedy under the Mitchell-Lama law.

Using language that seems as if it were written specifically to address DHCR's "no authority, no ability" position in this case, The New York Court of Appeals explained why DHCR could have and should have asked this Court to use its equity powers to prevent NTIII's Owners/Directors from escaping liability for their unlawful acts: "[I]n its simplest analysis, we have here the case of a meritorious claim, the only defense to which is predicated upon the assumed absence of a remedy. 'Equity suffers not a right without a remedy.'" Sherman v. Skuse, 166 N.Y. 345, 352, 59 N.E. 990, 992 (N.Y. 1902) (citation for quotation absent in original); see also Broom's Legal Maxims, 153 quoted in Hahl v. Sugo, 27 Misc. 1, 3, 57 N.Y.S. 920, __ (N.Y. Sup. Ct, Erie County 1899) ("If a man has a right, he must . . . have a means to vindicate and maintain it, and a remedy if he is injured in the exercise and enjoyment of it; and, indeed, it is a vain thing to imagine a right without a remedy, for want of right and want of remedy are reciprocal."). The Court of Appeals went on to explain that "under such conditions it

is quite clear that equity ought not lend itself to a purely technical defense. . . ." Id. (emphasis added).

In short, equity provides a remedy against NTIII's Owners/Directors for unlawfully depriving Westview of $1,000,000 in income for their own personal benefit. DHCR should have known the courts were empowered to provide it with such an equitable remedy, see Hahl v. Sugo, 27 Misc. at 3, 57 N.Y.S. at __ (explaining that, if "a plain, adequate, and complete remedy does not exist . . . to protect acknowledged rights, and to prevent acknowledged wrongs . . . , then it is obvious, that [the court] has an expansive power, to meet new exigencies." (emphasis added)). As such, DHCR should have taken legal action to recoup the lost $1,000,000.

3. DHCR Has An Express Right And Obligation Under Mitchell-Lama Law To Attempt To Recoup The $1,000,000 In Lost Westview Income From NTIII's Owners/Directors Instead Of Increasing Tenants' Rents To Pay for The Loss

While basic principles of equity would not, for want of a remedy, permit NTIII's Owners/Directors to escape liability for unlawfully warehousing apartments at Westview, and while this Court could use its equity power to fashion a remedy here, doing so is not necessary. Such is the case because the Mitchell-Lama law itself required DHCR to sue the Owners/Directors to recoup the $1,000,000 in lost Westview income.

When the Housing Company, acting at the direction of its Owners/Directors, submitted its application for an 88% rent increase at Westview without acknowledging or accounting for the $1,000,000 loss their warehousing had caused, DHCR became obligated to sue the Owners/Directors to recoup the lost revenue rather than forcing the tenants to pay for it. The statutory provision that required DHCR to institute legal action against NTIII's

Owners/Directors,[29] entitled "Proceedings against housing companies," is found at N.Y. Priv. Hous. Fin. Law §91(1), and states:

> Whenever the commissioner shall be of the opinion that a housing company is . . . doing or is about to do anything, or permitting anything, or is about to permit anything to be done, contrary to and in violation of law . . . or which is improvident or prejudicial to the interest of . . . the tenants, the commissioner shall commence an action or proceeding in the supreme court of the state of New York in the name of the commissioner, . . . alleging the violation complained of and praying for appropriate relief. . . . The final judgment in any such action or proceeding shall either dismiss the action or proceeding or direct that an order or an injunction, or both, issue, or provide for the appointment of a receiver as prayed for in the petition, or grant such other relief as the court may deem appropriate.[30]

It is important to note that §91(1) contains one provision that is discretionary – "shall be of the opinion" – and one provision that is compulsory – "shall commence an action." Both provisions will be discussed in turn.

a. It Was Arbitrary And Capricious, Under The Discretionary Provision of §91(1), For DHCR To Have Concluded That NTIII's Application For A Rent Increase Did Not Constitute "Doing . . . Anything . . . Which Is Improvident Or Prejudicial To The Interests Of . . . The Tenants"

In accordance with the discretionary provision of §91(1), DHCR is required to take legal action against a housing company "Whenever the commissioner shall be of the opinion that a housing company is doing or is about to do anything . . . which is improvident or prejudicial to

[29] DHCR's ability to pierce the corporate veil and proceed directly against NTIII's Owners/Directors is discussed in Part II.B.3.c, *infra*.
[30] A provision containing very similar language is found at N.Y. Priv. Hous. Fin. Law § 32(7).

the interest of . . . the tenants." In analyzing its responsibilities under §91(1), we know that DHCR[31] had already drawn or should have drawn the following conclusions:

- Westview's Housing Company, upon the instructions of its Owners/Directors, unlawfully warehoused apartments at Westview;
- Whenever Mitchell-Lama's building's apartments are warehoused, as opposed to rented, it deprives that building of income;
- Because Mitchell-Lama rents are established at a level that is designed to have a building's income meet its expenses, anytime a building is deprived of income, there is a strong likelihood that certain expenses which should have been met will not be met; and
- On January 23, 2008, NTIII sought a rent increase that (a) did not acknowledge or account for the $1,000,000 in lost warehousing income, (b) did not account for money that, pursuant to Westview's 2003 BRD, was collected for specific capital expenses that were never made, and (c) would require the tenants re-pay for certain capital expenses that were previously funded and would already have been made if the warehousing had not deprived Westview of $1,000,000 in income.

Although DHCR has discretion under §91(1) to determine if an action by a housing company is improvident or prejudicial to the interest of a Mitchell-Lama building's tenants, it may not exercise that discretion in and arbitrary and capricious manner. Under New York law, "[t]he arbitrary or capricious test chiefly relates to whether a particular action should have been taken or is justified and whether the administrative action is without foundation in fact. Arbitrary action is without sound basis in reason and is generally taken without regard to the facts." Pell v. Board of Educ., 34 N.Y.2d 222, 231, 313 N.E.2d 321, 325, 356 N.Y.S.2d 833, 839 (1974) (internal quotations and citations omitted). What is striking about DHCR's conclusion that it was not obligated to pursue legal action against NTIII's Owners/Directors is that it is not

[31] Although the Mitchell-Lama law and regulations frequently refer to the commissioner of DHCR's responsibilities or actions, because they are practically the responsibilities and actions of DHCR, herein the term "DHCR" and the pronoun "its" will be frequently substituted for "commissioner" and "she."

merely inconsistent with Petitioners' version of the facts, it is inconstant with DHCR's own version of the facts.[32]

It was DHCR's own determination that warehousing had occurred at Westview pursuant to the directions of NTIII's Owners/Directors. See Ex. C, E. It was DHCR's own conclusion that the "revenue loss due to 'warehousing'" at Westview was $1,065,777. See Admin. R., A-15 at 1. And it was DHCR's conclusion that warehousing unjustly lead to high rents for tenants. See Ex. E at 1-2.

The budget submitted by NTIII in connection with the 2008 BRD does nothing to account for the warehousing losses other than to pass them along to the tenants. The budget does not state that it reflects $1,000,000 less income than it otherwise should NTIII's Owners/Directors warehoused apartments for the own, personal benefit. Nor does the budget state that it contains $1,000,000 in capital expenses that would have previously been completed if NTIII's Owners'/Directors' unlawful warehousing had not deprived Westview of the income needed to pay for them. Nevertheless, DHCR concluded that, in submitting a rent increase application that sought to nearly double tenants' rents without accounting for the $1,000,000 in lost warehousing income, the Housing Company did not "do[] . . . anything . . .prejudicial to the interest of . . . the tenants." This action falls squarely within the Court of Appeals' definition of an arbitrary decision, in that it clearly is "without sound basis in reason and is generally taken without regard to the facts." As such, this Court should hold that DHCR should have found that NTIII's submission of the 2008 BRD rent increase application, in the form it was presented, constituted "doing [something] . . . prejudicial to the interest of . . . the tenants."

[32] Petitioners have to assume, for purposes of this brief, that DHCR was aware of the existence of §91(1); however, it is entirely possible DHCR did not even contemplate its powers under that section.

b. Under The Compulsory Provision of §91(1), DHCR Was Required To Take Legal Action Against NTIII's Owners/Directors To Recoup The $1,000,000 In Income Lost To Warehousing At Westview

At the time NTIII submitted its rent increase application on January 23, 2008, DHCR had already concluded that the Housing Company, at the direction of NTIII's Owners/Directors, had warehoused apartments at Westview and that the warehousing had cost Westview $1,065,777 in income. Moreover, DHCR should have concluded that NTIII's rent increase application, which sought to have the tenants' rents increased to compensate for the lost income/increased expenses attributable to warehousing, was something "prejudicial to the interest of . . . the tenants." Consequently, in accordance with the compulsory provision of §91(1), DHCR was required to bring a legal action against the Housing Company in the New York Supreme Court to recoup the $1,000,000 lost to the Owners'/Directors' unlawful warehousing.[33]

The fact that NTIII's application, which did not acknowledge or account for NTIII's warehousing, was prejudicial to the tenants was borne out by the fact that DHCR granted the owners a 14.9% rent increase on July 29, 2009. That rent increase would not have been necessary had DHCR held NTIII's Owners/Directors responsible for the financial consequences of their self-serving and very profitable warehousing practices.

c. Because Westview's Warehousing Was Done Solely For The Benefit Of NTIII's Owners/Directors, DHCR Would Have Been Able To "Pierce The Corporate Veil" Of The Housing Company And Directly Sue Its Owners/Directors

The very title of §91 – "Proceedings against housing companies" – makes clear that the section empowers DHCR to take legal action against a corporate entity. Nevertheless, any

[33] Because § 91(1) empowers DHCR to bring an action based on harm done or about to be done to the tenants, in such as action DHCR essentially stands in the shoes of the tenants as the plaintiff. DHCR, therefore, has the right to make claims based upon any harms caused to the tenants and to seek remedies that will make the tenants whole.

attempt by the Owners/Directors to use this language to escape personal liability for their unlawful, self-serving warehousing would be soundly rejected by any court in the State of New York. Although the Housing Company was responsible for instituting and effectuating the warehousing at Westview, in this case, under §91(1), DHCR would be permitted and required to proceeded against NTIII's individual Owners/Directors to recoup the $1,000,000 lost to warehousing.

In order to understand the law governing the liability of the individual owners of Westview, one must first understand the corporate structure of Westview's ownership. As a starting point, NTIII LP (the Housing Company) is the beneficial owner of Westview, while NTIII Inc. is the legal owner of Westview. See Sales-Purchase Agreement, dated January 1, 2004, at 1, ("Sales-Purchase Agreement"), a true and correct copy of the relevant pages of which is attached hereto as Exhibit F.[34] Next, it is important to note that NTIII Inc. is the general partner of NTIII LP. Id. This means that, as a matter of law, NTIII Inc. exercises control over NTIII LP and does not enjoy any limited liability with respect to NTIII LP's actions and activities. Finally, the individual owners of NTIII Inc. are protected from individual liability for NTIII Inc.'s actions and activities, in accordance with and subject to the limits of New York law, because NTIII Inc. is a New York corporation.

The warehousing of apartments at Westview by NTIII's Owners/Directors provides a textbook case of when courts will "pierce the corporate veil" and allow aggrieved parties, or

[34] As the Sales-Purchase Agreement is a 60 page document and is cited for only two, limited propositions in this brief, Petitioner is only including the two relevant pages of the document as an exhibit here. If the Court or any of the Respondents object to Petitioner not including a complete copy of the document, we will submit it to the Court and all parties immediately upon request.

those suing on their behalf, to bring legal action directly against a corporation's directors and/or shareholders (i.e. owners). As the New York Court of Appeals has held,

> The law permits the incorporation of a business for the very purpose of enabling its proprietors to escape personal liability but, manifestly, the privilege is not without its limits. Broadly speaking, the court will disregard the corporate form, or, to use accepted terminology, "pierce the corporate veil", whenever necessary to prevent fraud or achieve equity.

Walkovszky v. Carlton, 18 N.Y.2d 414, 417, 223 N.E.2d 6, 7, 276 N.Y.S.2d 585, 587 (N.Y. 1966) (internal quotations and citations omitted). See also Wm. Passalacqua Builders, Inc. v. Resnick Dev. S. Inc., 933 F.2d 131, 137-38 (2d Cir. 1991) (providing a detailed examination of laws governing piercing the corporate veil in New York State).

The New York Court of Appeals clarified the precise rule that allows DHCR, under the fact presented here, to pierce NTIII Inc.'s corporate veil and bring a lawsuit against its owners to recoup the $1,000,000 in warehousing losses:

> In determining whether liability should be extended to reach assets beyond those belonging to the corporation, we are guided, as Judge Cardozo noted, by general rules of agency. In other words, whenever anyone uses control of the corporation to further his own rather than the corporation's business, he will be liable for the corporation's acts upon the principal of *respondeat superior* applicable even where the agent is a natural person. Such liability, moreover, extends not only to the corporation's commercial dealings but to its negligent acts as well.

Walkovszky, 18 N.Y.2d at 417, 223 N.E.2d at 7-8, 276 N.Y.S.2d at 587-88 (emphasis added) (internal quotations and citations omitted). The Owners/Directors of NTIII Inc. were directly, solely and personally responsible for ordering the warehousing at Westview. This can be established through several irrefutable facts: (1) by virtue of its corporate form, the Owners/Directors of NTIII Inc. exercised control over NTIII Inc.; (2) the Owners/Directors of NTIII Inc. exercised complete and exclusive control over the Housing Company, as NTIII Inc. is

the Housing Company's general partner; (3) the Housing Company initiated and controlled the warehousing at Westview and was the only entity that could have done so; (4) NTIII's Owners/Directors stood to gain personally, and in fact realized significant financial gains, from the warehousing at Westview; and (5) the Housing Company did not stand to gain, and in fact suffered losses as a result of the warehousing at Westview.[35] These indisputable facts provide sufficient grounds for this Court to conclude, as DHCR should have, that NTIII's Owners/Directors could and should be held liable for the $1,000,000 lost to warehousing at Westview.

Even assuming, *arguendo*, that the Housing Company generally operated independently of NTIII's owners, such a fact is of no consequence in determining if the corporate veil can be pieced with respect to the warehousing. This is the case because the veil may be pierced even with respect to a single, isolated action. See Austin Powder Co. v. McCullough, 216 A.D.2d 825, 826, 628 N.Y.S.2d 855, 856 (3d Dept 1995) ("The decision whether to pierce the corporate veil will depend upon the facts and circumstances of each case. Where a plaintiff can establish that the owner exercised complete domination of the corporation with respect to the transaction in question and said domination was used to commit a fraud or wrong against the plaintiff resulting in plaintiff's injury, the corporate veil may be pierced." (emphasis added)).

Beyond the issue of veil piercing, the Mitchell-Lama law and regulations contemplate housing company directors being held personally liable for their injurious actions. This is demonstrated by the fact that the Mitchell-Lama law specifically exempts DHCR-appointed

[35] The warehousing at Westview was antithetical to the corporate purposes of the Housing Company because it deprived the company of funds it needed to properly operate Westview. In fact, if the lost $1,000,000 is recouped from the Owners/Directors, it would go to the Housing Company and be used to offset Westview's expenses.

housing company directors from such liability. See N.Y. Priv. Hous. Fin. Law § 32(6) ("In the absence of fraud or bad faith, directors so appointed [by DHCR] shall not be personally liable for debts, obligations or liabilities of the corporation."). See also Cadplaz Sponsors, Inc. v. Cadman Towers, Inc., 84 Misc.2d 961, 966-67, 376 N.Y.S.2d 805, 809-10 (Sup. Ct., New York County 1975). Furthermore, the fact that the exemption for DHCR-appointed housing company directors only protects them in cases where there has been no fraud or bad faith, enables one to conclude that non- DHCR-appointed housing company directors are subject to personal liability even in cases where no fraud or bad faith is alleged; otherwise, the exemption would render the provision of immunity meaningless.

It is beyond dispute that prior to the issuance of its Rent Increase Order, DHCR concluded that NTIII had unlawfully warehoused apartments at Westview and that doing so had deprive Westview in more than $1,000,000 in income. Having done so, it would be logically impossible for DHCR not to conclude that NTIII's attempt to secure a rent increase at Westview without acknowledging to otherwise accounting for the lost warehousing revenue (other than increasing tenants' rents to pay for it) was not "improvident or prejudicial to the interest of . . . the tenants." Nevertheless, that seems to be the decision DHCR's reached, and that decision was plainly arbitrary and capricious.

4. DHCR Should Have Pursued, And This Court Should Order DHCR To Pursue, A Claim For Unjust Enrichment Against NTIII's Owners/Directors

DHCR's decision to increase Westview's tenants' rents to cover the $1,000,000 in lost revenue/increased expenses that resulted from the Owners'/Directors' unlawful warehousing is likewise arbitrary and capricious. Rather than upholding DHCR's unjust rent increase order, which forces Westview's tenants to pay for warehousing that was initiated by and exclusively

benefitted NTIII's Owners'/Directors', this Court should conclude that the proper way to put Westview back into the financial position it would have been in if not for the Owners'/Directors' unlawful warehousing would be to order DHCR to fulfill its obligation under §91(1) by seeking to legally hold the Owners/Director liable for the $1,036,364 in income they deprived from Westview. This figure, it should be noted, constitutes only a fraction of the total ill gotten gains the Owners/Directors secured as a result of their unlawful actions. See Part II.B.4.a, *infra*.

Specifically, the claim DHCR should institute against NTIII's individual Owners/Directors, pursuant to its authority under §91 of the Mitchell-Lama law, is one for unjust enrichment. A claim for unjust enrichment has three elements: (1) the defendant was enriched, (2) such enrichment was at the plaintiff's expense, and (3) in equity and good conscience the defendant should be required to return the money or property to the plaintiff. See New York City Econ. Dev. Corp. v. T.C. Foods Imp. & Exp. Co., 2006 N.Y. Slip Op. 50754U at *3, 11 Misc.3d 1087A, __, 819 N.Y.S.2d 849, __ (N.Y. Sup. Ct., Queens County 2006). The remedy for unjust enrichment is referred to as either "disgorgement of improper profits" or "restitution". Id.

DHCR's path to a successful recovery of the $1,000,000 in ill gotten gains from NTIII's Owners/Directors is best illustrated by examining a failed unjust enrichment lawsuit brought by a quasi-governmental entity known as the New York City Economic Development Corporation ("EDC") only a few years ago. In New York City Econ. Dev. Corp. v. T.C. Foods Imp. & Exp. Co., EDC was responsible for establishing and overseeing an urban renewal plan in the College Point section of Queens. As part of that plan, the deed for a parcel of property owned by T.C. Foods contained a restrictive covenant prohibiting the use of outdoor advertising billboards on the property. Despite this restriction, T.C. Foods erected a billboard, the value of which was

estimated at over $1.6 million. EDC brought an unjust enrichment claim in New York Supreme Court to recover damages, in the form of restitution, from T.C. Foods.

Although T.C. Foods was clearly enriched by its unlawful conduct, what prevented EDC from prevailing in the lawsuit was its inability to demonstrate that T.C. Foods' enrichment was at EDC's expense. Although T.C. Foods was clearly enriched by renting the advertising space of the billboard, EDC could not show T.C. Foods was enriched at EDC's expense. This was the case because billboard advertising was prohibited. As such, EDC could not claim it had been deprived of an economic benefit it would have otherwise received. See Id., 2006 N.Y. Slip Op. at *4, 11 Misc.3d at __, 819 N.Y.S.2d at __. That flaw in its case, and only that flaw, doomed EDC's unjust enrichment claim.

For an unjust enrichment action by DHCR against the Owners/Directors, however, New York City Econ. Dev. Corp. helps to demonstrate how DHCR can satisfy all of the required elements of the claim, including the one that EDC could not. Unlike in New York City Econ. Dev. Corp., where advertising rentals were prohibited but occurred anyway, in the case of Westview, apartment rentals were required but did not occur. This is a critical difference because in New York City Econ. Dev. Corp., the plaintiff was not deprived of an economic benefit it would have received but for the conduct that enriched the defendant. Here, however, DHCR (standing in the shoes of New York State/DHCR and/or Westview's tenants) was deprived of an economic benefit that would have realized but for the Owners'/Directors' unlawful conduct.[36]

[36] For further discussion of the damages to New York State/DHCR and Westview's tenants, see Part II.B.4.b, *infra*.

Before examining DHCR's unjust enrichment claim against NTIII's Owners/Directors, it is important to briefly discuss two relevant points of law. First, an unjust enrichment claim does not depend upon the existence of a valid contract between the parties. See Artukovich & Sons, Inc. v. Reliance Truck Co., 126 Ariz. 246, 248, 614 P.2d 327, 329 (AZ 1980); Hertz v. Fiscus, 98 Idaho 456, 567 P.2d 1, 2 (ID 1977). Frequently, unjust enrichment claims are based on quasi- or constructive-contracts. As the First Department, Appellate Division has noted,

> [A] *quasi* or constructive contract rests upon the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth it is not a contract or promise at all. It is an obligation which the law creates, in the absence of any agreement, when and because the acts of the parties or others have placed in the possession of one person money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which *ex aequo et bono*[37] belongs to another. Duty, and not a promise or agreement or intention of the person sought to be charged, defines it. It is fictitiously deemed contractual, in order to fit the cause of action to the contractual remedy.

Saunders v. Kline, 55 A.D.2d 887, 887, 391 N.Y.S.2d 1, 1-2 (1st Dept 1977). See also Heller v. Kurz, 228 A.D.2d 263, 264; 643 N.Y.S.2d 580, 581 (1st Dept. 1996) ("A cause of action under a quasi contract theory only applies in the absence of an express agreement, and is not really a contract at all, but rather a legal obligation imposed in order to prevent a party's unjust enrichment." (internal citation omitted)); Artukovich & Sons, 126 Ariz. at 248, 614 P.2d at 329 ("Contracts implied-in-law or quasicontracts, also called constructive contracts, are inferred by the law as a matter of reason and justice from the acts and conduct of the parties and circumstances surroundings the transactions, . . . and are imposed for the purpose of bringing about justice without reference to the intentions of the parties."). In fact, under Mitchell-Lama law Westview's Housing Company's certificate of incorporation is required to state that "the company has been organized to serve a public purpose." N.Y. Priv. Hous. Fin. Law §13(13). As

[37] "According to the right and good" or "from equity and conscience."

such, Westview's certificate of incorporation essentially creates a quasi-contract between the Housing Company and the public it serves; to wit, the State of New York, DHCR and Westview's tenants.

The argument in favor of finding a quasi-contract between the housing company and Westview's tenants is further bolstered by 9 NYCRR §1725-2.3(a), which states, with respect to Westview's Housing Company's board of directors, "members of the board of directors have an obligation to tenants of their project. Tenants or cooperators will seek and demand the most economical operation of the development in order to obtain the lowest possible rent or carrying charge."[38] As such, any claim by NTIII's Owners/Directors that the Housing Company does not have a valid contract with the State of New York, DHCR or the tenants, despite the obligations it assumed with respect to each upon its enrollment in and acceptance of the benefits of the Mitchell-Lama program, is of no consequence in analyzing a claim for unjust enrichment brought by DHCR on its own, New York State's and/or the tenants' behalf.

Second, "it is not a necessary element of a cause of action for unjust enrichment to show that plaintiff suffered a loss corresponding to the gain received by the defendant." Saunders, 55 A.D.2d at 887, 391 N.Y.S.2d at 2. See also Artukovich & Sons, 126 Ariz. at 248, 614 P.2d at 329; Restatement, Restitution, §§ 1, cmt. e, 128, cmt. f. As such, as long as DHCR can demonstrate that the warehousing at Westview came at the expense of DHCR, New York State and/or the tenants, it is irrelevant whether the harm was greater than, less than or equal to the benefits the Owners/Directors received.

[38] Clearly, the Owners'/Directors' decision to unlawfully deprive Westview of $1,000,000 in rental income for their personal benefit does not constitute "the most economical operation" of Westview.

a. NTIII's Owners/Directors Were Personally Enriched By Their Illegal Warehousing At Westview

Returning to the three elements of an unjust enrichment claim discussed, *supra*, it is clear, from an application of the present facts to those elements, that DHCR would have prevailed had it brought such a lawsuit against NTIII's Owners/Directors, as it was required to do under §91(1).[39]

The first element of an unjust enrichment claim is that "the defendant was enriched." The unlawful warehousing at Westview, which was done solely and exclusively for the personal benefit of NTIII's Owners/Directors, succeeded in enriching them in three ways. The first way the Owners/Directors were enriched by the warehousing at Westview was through the substantial increase in Westview's value it creased for a sale to a private purchaser, which in this case was the Sheldrake Organization. As New York State Inspector General Hamann explained:

> The law permits housing companies to "buy out" of the Mitchell-Lama program after a certain period of time if the mortgage is fully paid. A buyout can present the owner with substantial profits, since vacant apartments may be sold or rented at market prices once the development leaves the program. Housing companies may not receive the same windfall from occupied apartment. . . . Thus, where a buyout is imminent, the housing company may "warehouse" apartments by holding them off the market.

Verified Pet., Ex. I at 49.

[39] At a minimum, this Court should conclude that the facts and law present a strong enough case against NTIII's Owners/Directors that DHCR should have brought suit against the Owners/Directors before proceeding to raise Westview's tenants' rents. To the extent the building's income will be less than its expenses during the pendency of a case against the Owners/Directors (something that did not happen last year despite NTIII's and DHCR's claim it would, and that WTI's accountant does not foresee happening this year), the $1.1 million NTIII presently has in its tenant-funded reserve fund is more than enough to ensure the building's solvency while DHCR pursues its case against the Owners/Directors. See Freedman Aff., ¶¶7, 9. See also Admin. R., A-17 at 8.

While it is difficult (and unnecessary) to pinpoint the precise increase in Westview's value NTIII's Owners/Directors secured by maintaining Westview's unlawful vacancies, the economic gain, if the sale had gone through, would likely have been around $15,000,000.[40] The fact that the Owners/Directors were not able to realize this benefit because the sale fell through does not negate the fact that they created the benefit, because under the law the theft of something of speculative/non-precise value can still constitute injury to plaintiff for purposes of maintaining a claim for unjust enrichment. See, e.g., Zacchini v. Scripps-Howard, 422 U.S. 562, 575-76 (1977) (defendant's enrichment through its unauthorized broadcasting of entertainer's performance, which constituted the theft of good-will, was adequate to maintain plaintiff's unjust enrichment claim). It is certainly fair to assume that the favorable terms of the Owners'/Directors' sales agreement with Sheldrake, which ultimately produced significant profits for them, were made possible, at least in part, by the favorable conditions under which Westview would be sold; to wit, with nearly 10% of its units vacant.

The second way the Owners/Directors were enriched by the warehousing at Westview was through the Sales-Purchase Agreement Amendment, which guaranteed the Owners/Directors would profit directly off of the vacancies, even if the building was not sold. Under the Sales-Purchase Agreement Amendment, regardless of whether the sale went thorough or not, Sheldrake was required to pay the owners 50% of the rents that would have been collected if not for the warehousing (i.e. the "non-naturally occurring vacancies") See Ex. D at 2-3. The compensation for 50% of the warehousing losses the Owners/Directors should have received

[40] During negotiations over the sale of Westview between WTI and NTIII, NTIII took the position that the value of the existing vacant apartments on the open market was $15,000,000. See Affidavit of Opher Pail ("Pail Aff."), at ¶14.

from Sheldrake, according to both Westview's accountant and DHCR, is in excess of to $500,000.[41]

The third way the Owners/Directors were enriched by the warehousing at Westview is the existence of a large number of vacant apartments was an essential element of the Westview sales agreement between NTIII and Sheldrake. See, e.g., Ex. D at 2-3, F at 14. If not for the existence of numerous vacant apartments at Westview produced by the warehousing, the sales agreement would not have gone through in its present form, which was highly favorable to the Owners/Directors.[42] The favorability of the sales agreement to the Owners/Directors is beyond any reasonable dispute; to wit, even through the sale was delayed and ultimately fell through, and even though the Owners/Directors did not realize the $15,000,000 in increased sales value they hoped the warehousing vacancies would create, they nonetheless secured at least $4,000,000 from Sheldrake as a result of the sale's failure. See November 30, 2006 letter from North Town Phase III Associates, L.P. to J. Christopher Daly at 1, a true and correct copy of which is attached hereto as Exhibit G ("If by action of the Purchaser's default under the Agreement, as modified hereby, the Closing does not occur on the Closing Date, the Agreements shall immediately terminate and the Sellers shall, without further notice to the Purchaser, retain all funds theretofore received from the Purchaser pursuant to the Agreement, as modified hereby, as liquidated damages and as the Sellers' sole remedy. . . . The Parties acknowledge and agree that upon the execution and payment pursuant to the Letter Amendment, the Sellers will have

[41] Although this payment is clearly called for in the Sales-Purchase Agreement Amendment, Petitioners have not been able to verify if the payment was made. However, even if the payment has not yet been made, the Owners/Directors have the right to collect it; as such, the $500,000 should be considered an asset the Owners/Directors gained from their illegal warehousing.

[42] The fact that the warehousing was specifically referenced in both the Sales-Purchase Agreement, see Ex. F, and the Sales-Purchase Agreement Amendment, see Ex. D, demonstrates that warehousing vacancies were an integral part of the sales agreement.

received $4,500,000 from the Purchaser, as payment on account of the Purchase Price." (emphasis added)). That is some consolation prize; and it was provided, at least in part, courtesy of Westview's unlawful vacancies.

If DHCR's "no authority, no ability" enforcement position taken in this case was in fact true, the Owners'/Directors' decision to unlawfully warehouse apartments at Westview was a wise, rational business decision, because warehousing presented them with a no-risk, high reward scenario. According to DHCR's implausible position here, the way the Mitchell-Lama laws and regulations were drafted essentially invited NTIII's Owners/Directors to warehouse Westview's apartments, to deprive the building of $1,000,000 in income so as to increase their personal profits by $15,000,000 if the building was sold, and to do so without any risk of being held financially liable for their unlawful acts. Such a position is inaccurate and indefensible.

In truth, DHCR had a cause of action against the Owners/Director for unjust enrichment, the first element of which – that the Owners/Directors were enriched – is satisfied because the warehousing increased the value of their building on the private market, produced an agreement that personally compensated them for the building's lost vacancy income and enabled them to profit handsomely off the failed sale of the building.

b. NTIII's Owners'/Directors' Enrichment Was At The Expense Of New York State/DHCR And Westview's Tenants

The second element of an unjust enrichment claim – that defendants were enriched at the plaintiff's expense – is also satisfied here. There are two potential, non-mutually exclusive actions DHCR could assert against NTIII's Owners/Directors. The first is on behalf of New York State/DHCR and the second is on behalf of Westview's tenants. In each case, NTIII's Owners'/Directors' enrichment was at the plaintiff's expense.

In stating the claims of New York State/DHCR, DHCR can establish the Owners'/Directors' enrichment was at the plaintiff's expense on two grounds. First, the Owners'/Directors' warehousing cost Westview $1,000,000 in revenues, which are needed to keep rents affordable in the building. Because a building's projected income must meet its projected expenses under Mitchell-lama law, when a building faces an apparent revenue shortfall, the lost income is typically made up by increasing rents. See Ex. E at 1-2. This increase in rents poses a significant threat to the affordable housing at Westview.[43] Second, the warehousing also deprived the State/DHCR of dozens of affordable housing units, which it paid to have made available to qualified tenants when it granted NTIII tax breaks and provided it with a low interest mortgage under the Mitchell-Lama program. The warehousing deprived the State/DHCR of the full benefit of its bargain with NTIII.

In asserting the claims of Westview's tenants, DHCR has two ways in which it can categorize the Owners'/Directors' enrichment at the plaintiff's expense; namely, the unlawful warehousing that resulted in Westview losing $1,000,000 in rental income at Westview can be said to have damaged the tenants by depriving Westview of $1,000,000 in income or inflating Westview's expenses by $1,000,000. Regardless of whether the Court views the impact of the Owners/Directors' warehousing as affecting the income or expense side of Westview's ledger, the result is that the warehousing (as well as DHCR's failure to hold the Owners/Directors financial accountable for it) directly lead to a rent increase that otherwise would not have been necessary, even based upon DHCR's inflated and inaccurate budget projections. As such, the Owners'/Directors' enrichment was at the tenants' expense.

[43] Westview's rents were so high, even prior to the recent rent increase, that it referring to it as "affordable housing" for low and middle income New Yorkers already seemed somewhat strained. See Pail Aff. ¶4.

When one looks at the warehousing loss as a deprivation of income, the analysis is very simple. In its rent increase application, the Housing Company claimed a rent increase was needed at Westview to generate additional income to meet the building's expenses. What the application failed to note was that Westview would have had an additional $1,000,000 on hand if not for the Owners'/Directors' warehousing and DHCR's subsequent failure to recoup the lost income. DHCR acknowledges that the Owners/Directors unlawfully warehoused apartments at Westview, see Ex. C, E, and that the warehousing deprived Westview of $1,065,777 in income. See Admin. R., A-15 at 1. And DHCR knew or should have known, using it own figures, that if it recouped that lost money from the Owners/Directors, the tenants would be spared a rent increase, because the income side of the ledger would be increased by $1,065,777 – which is essentially the same amount as DHCR's inaccurately projected revenue shortfall.[44] Conversely, however, because the Owners'/Directors' warehousing cost Westview $1,000,000 in rental income, and because DHCR failed to recoup the Owners'/Directors' ill-gotten gains, the tenants were hit with a rent increase of 14.9% that otherwise would have been 0%.

As noted above, one can also view the tenants' damages from the expense side of the ledger. During Westview's last rent increase in 2003, as is the case with all rent increases, DHCR set rents at a level that would ensure Westview's projected income would meet its projected expenses. These expenses include both regular costs that cannot be avoided by NTIII, even in the event of an income shortfall (e.g., electric, water) ("Regular Expenses") and capital expenditures that NTIII could avoid making, even though doing so might place the tenants' health and safety at risk (e.g., elevator repairs) ("Capital Expenses").

[44] DHCR's projected revenue shortfall for Westview in the budget year ending June 30, 2010 is $1,127,600. See Admin. R., A-38 at 4.

The Owners/Directors warehousing of apartments created a $1,000,000 budget shortfall at Westview, which deprived the building of its ability to pay all the expenses that were funded under the 2003 BRD. This meant the building's income had to be rationed. Because Regular Expenses could not be avoided, they were incurred and paid as expected; however, certain Capital Expenses were not. The resulting damage to the tenants occurred on two levels.

First, following the 2003 BRD, tenants' rents were increased to pay for numerous Capital Expenses that were never undertaken because the $1,000,000 cash shortfall made doing so impossible. Notwithstanding the fact that these Capital Expenses were not incurred or paid, all of the tenants in occupied apartments paid their share of these projected but unincurred costs. To what or to whom, then, did the tenants' money specifically go? WTI has not been able to get an answer to this question.[45] What WTI does know for certain is where it did not go; namely, to pay for the Capital Expenses for which it was expressly provided. That lost rent, which was designated to go towards the unincurred Capital Expenses, constitutes damages to the tenants.

Second, numerous Capital Expenses provided for in the 2003 BRD budget, despite the fact that a rent increase to pay for them was collected from all of Westview's occupied apartments, were not undertaken due to the $1,000,000 shortfall. Subsequently, those same Capital Expenses reappeared as projected expenses in the 2008 BRD. This means the tenants are being asked to fund certain Capital Expenses, in full, a second time.

[45] WTI's accountant believes that a portion of this money went into the building's reserve fund, which grew from $750,000 at the end of 2003 to over $1,200,000 by 2008. See Admin. R., A-17 at 8.

One such example of this is the Capital Expense NTIII and DHCR call "elevator modernization." According to WTI's Accountant Marc Freedman, "[t]he Housing Company collected $752,000 in 2003, 2004 as part of its rent increase explicitly to do the elevator upgrades. These were never done. Instead $600,000 of the current capital budget is earmarked for this work." See Admin. R., A-17 at 8. It appears NTIII was concerned about asking for elevator modernization funds twice, because they did not list elevator modernization as an expense in their initial January 23, 2008 rent increase application. See Admin. R., A-1. However, within weeks of submitting it initial application, the largest single expense item in the rent increase application had to be sharply reduced.[46] NTIII recognized that if further expense reduction were required, it might compromise its ability to secure a high enough rent increase to qualify for bank financing to pay off its existing mortgage, see Part I.D, *supra*, as well as undermine the other primary purpose of the rent increase: to frighten the tenants into accepting the terms of NTIII's sales offer to WTI. That is why on April 22, 2008, less than three months later after submitting its initial application, NTIII supplemented its request for a rent increase to

[46] That expense, a Tax Equivalent Payment (TEP), which accounted for nearly $3,500,000 of NTIII's projected increased expenses at Westview, see Admin. R., A-1 at 2 n. 2, had to be reduced to under $500,000. See Admin. R., A-3 at 1. See also Admin. R., A-13 at 7 ("At the time the housing company was preparing its B/RD projection, no agreement on the TEP had yet been reached. The requested rent increase was based upon the TEP being calculated using assessed valuation. After the agreement was reached, the housing company asked that DHCR revise the amount shown as its projection for this item – and the B/RD reflects this change. However, the company did not reduce or in any way adjust the amount of its request increase.").

include funding for "elevator modernization projects," just as it had in the 2003 BRD.[47] See Admin. R., A-4 at 1; A-13 at 23.

The bottom line is that NTIII requested funds for "elevator modernization" as part of its 2003 BRD, and DHCR responded by budgeting $752,000 for elevator modernization. See "Capital Expenditures and Extraordinary Maintenance Items, DHCR Budget Projections, North Town Phase III Hse UDC-068", a true and correct copy of which is attached hereto as Exhibit H. Then, in a supplemental request made during the 2008 BRD, NTIII asked for funding for "elevator modernization" again, see Admin. R., A-4 at 1; A-13 at 23, and DHCR responded by budgeting $600,000 for the very same expense. See Admin. R., A-5, at 31 (document page titled "Capital Expenditures and Extraordinary Maintenance Items, DHCR Budget Projections, Westview UDC-068").

If the Capital Expenses in the 2008 BRD that were also funded in the 2003 BRD, like elevator modernization, had been fully funded (which did not occur because of the warehousing), or if DHCR had restored full funding to the previously budgeted Capital Expenditures by recouping the lost $1,000,000 from the Directors/Owner, the expense side of the ledger in the 2008 BRD would have been $1,000,000 lower and no rent increase would have been necessary.

So regardless of whether this Court looks at the Owners'/Directors' warehousing as depriving Westview of $1,000,000 in income, or as creating $1,000,000 in additional expenses

[47] NTIII's request contains the unusual statement that "[a]lthough we have neither determined the scope of work nor sought prices" at the time it sent the letter, it nonetheless stated its belief that increasing Westview's anticipated expenses by "$250,000 per [elevator] car is appropriate at this time." See Admin. R., A-4 at 1. The addition of this $2,000,000 elevator modernization expense (over two years) was sufficient alone to raise NTIII's per room rent increase request by $30.22. See Admin. R., A-3 at 1, A-4 at 1.

that should have already been paid, the damage to the tenants, in the form of a 14.9% rent increase, is significant and real.

c. In Equity And Good Conscience, NTIII's Owners/Directors, Who Were Personally Enriched By The Illegal Warehousing At Westview, And Not Westview's Tenants, Should Be Responsible For Paying Back The $1,000,000 Warehousing Loss

With respect to the third and final element of an unjust enrichment claim – that in equity and good conscience the defendant should be required to return the money or property to the plaintiff – concepts of fairness and justice weigh heavily in favor of Petitioners.[48]

In deciding the Article 78 proceeding before it, this Court will likely weigh the same equitable considerations as a court would in analyzing the third element of an unjust enrichment claim by DHCR against NTIII. In both cases, the courts would need to decide if justice is best served by affirming DHCR's decision to increase tenants' rents to pay for the Owners'/Directors' unlawful warehousing or by ordering/allowing DHCR to recoup the income the Owners/Directors deprived Westview when they warehoused apartments for their own personal gain.

Respectfully, in the case at bar, the choice is clear, both as a matter of law and equity: NTIII's Owners/Directors, and not Westview's tenants, should be forced to restore the $1,000,000 in rental income Westview lost because of warehousing. This Court should take note that, even after paying $1,000,000 in restitution to the Housing Company, NTIII's

[48] Although, in this case, it is inaccurate to say the State of New York/DHCR or the Tenants would be made whole by returning the money to them. In fact, the money recouped from NTIII's Owners/Directors would go to their own Housing Company, albeit with explicit instructions to use the funds to offset expenses and decrease/eliminate the need for a rent increase at Westview. As such, it is more accurate to say the money would be used for the plaintiff's benefit, which is a distinction without a difference for purposes of an unjust enrichment claim.

Owners/Directors will still have personally profited by at least $3,000,000 as a direct result of their warehousing.

With respect to a future court deciding the issue in an unjust enrichment cause of action by DHCR against the Owners/Directors, the result would be the same. Equity and good conscious would dictate that the court order the disgorgement of $1,036,364 from the $4,000,000 in ill gotten gains the Owners/Directors realized as a result of their unlawful warehousing, see Part II.B.4.a, *supra*, rather than leaving the victims of the Owners'/Directors' unlawful warehousing – the State of New York, DHCR and Westview's tenants – to suffer their losses and, in the case of the tenants, to even pay for the damages the Owners/Directors caused.

5. DHCR's Decision Not To Pursue A Claim Against NTIII's Owners/Directors Based On The Tenants' Alleged "Unclean Hands" Runs Completely Contrary To The Law And Principles Governing The Unclean Hands Doctrine And Was Therefore Arbitrary And Capricious

DHCR suggests in its papers that it would be inappropriate to go after the Owners/Directors for the warehousing losses at Westview because WTI also participated in the warehousing. Specifically, DHCR points to WTI's tepid support for the continuation of warehousing as part of a potential sale of Westview that would have saved the affordable housing of every Westview's tenant, in perpetuity, regardless of whether they decided to buy or continue renting their apartments. See Pail Aff. at ¶ 16; Hirschhorn Aff., Ex. 11. DHCR's defense for not pursuing the Owners/Directors on behalf of the tenants, even if they could, is exclusively based on some misguided application of the unclean hands doctrine.[49] See DHCR Verified Answer ¶13 ("[P]etitioners are stopped from asserting the positions set forth in the petition with respect to . . . 'warehousing'"). While, *arguendo*, an apportionment of fault and

[49] The NTIII even has the audacity to raise this affirmative defense by name. See NTIII Verified Answer ¶6.

damages between NTIII and Westview's tenants might be called for under these circumstances, DHCR's draconian position that any recovery from the Owners/Directors is barred by WTI's eleventh hour, *de minimis* support for not filling the vacant, warehoused apartments at Westview is completely at odds with the law and principles governing the unclean hands doctrine. As such, it is arbitrary and capricious.

For DHCR to conclude that it could not (and should not) take action against NTIII's Owners/Directors due to what they view as the tenants' unclean hands completely disregards the clear rule that, in circumstances such as the one at bar, "unjust enrichments claims [are not] barred by . . . the doctrine of unclean hands, since the court must consider the relative culpability, bargaining power and knowledge of the parties." Chirra v. Bommareddy, 22 A.D.3d 223, 224, 802 N.Y.S.2d 118, 119 (1st Dept. 2005) (emphasis added). The requirement to examine the relative culpability of the parties, combined with the critically important rule that "a defendant may not invoke the clean hands doctrine in order to bar judicial scrutiny of his or her own malfeasance," Dillion v. Dean, 158 A.D.2d 579, 580, 551 N.Y.S.2d 547, 549 (2d Dept. 1990), has led courts to develop "a well-settled exception to the clean hands doctrine that one who, although at fault, is not equally at fault, will not be denied equitable relief." Id.

The Court should take note that warehousing at Westview began in February 2004 in connection with NTIII's attempt to sell Westview to Sheldrake. See Verified Pet., Ex. I at 50. However, it was not until September 15, 2006 that the tenants entered into a letter of intent with NTIII regarding the sale of Westview, in part, to the tenants ("LOI"). See Hirschhorn Aff., Ex. 11. As part of the LOI, the tenants were coerced into supporting a continuation of the Owners'/Directors' warehousing. The warehousing at Westview ended on February 2, 2007,

after DHCR Assistant Commissioner David Cabrera sent a letter to NTIII demanding they cease the unlawful practice. See Ex. C. [50]

As such, the warehousing at Westview lasted for a total of 36 months. For the first 31 ½ months warehousing occurred at Westview, it was exclusively supported and effectuated by NTIII for the sole benefit of its Owners/Directors. Subsequently, for the final 4 ½ months warehousing occurred at Westview, it continued to be effectuated solely by NTIII, but was supported by both NTIII and WTI.[51]

[50] DHCR accepts the fact the WTI was coerced into supporting warehousing, and even concedes in its answer that in an August 28, 2008 letter to DHCR, WTI stated that it had "no option but to agree to the continued vacancies or the owners would have refused to enter into the sales agreement." In fact, after receiving the Cabrera Warehousing Letter, NTIII president Charles Lucido made the same exact threat to DHCR. See Letter from Charles A. Lucido to David H. Cabrera, dated Feb. 6, 2007 at 2, a true and correct copy of which is attached as Exhibit I (requesting that DHCR "permit[] the vacancies to continue," at Westview and threatening that, if DHCR did not meet the demand, it would result in "the termination of . . . [NTIII's] efforts" to reach a deal with WTI to save Westview's affordable housing, and instead would "obviously result in the propert[y] being offered to third parties. The future of Westview . . . will then be determined by the new owners." Despite the rule that the parties' relative bargaining power should be taken into account, see Chirra, 22 A.D.3d at 224, 802 N.Y.S.2d at 119, and despite knowing the tenants had capitulated to same NTIII's threats DHCR had faced, DHCR nonetheless adopted the position that WTI's alleged unclean hands prevents it from suing NTIII's Owners/Directors to recoup all or some of Westview's warehousing losses. See McCurnin Aff. ¶33. That conclusion is arbitrary and capricious.

[51] WTI's short-lived support of warehousing began only after many years of opposing it as part of its intense fight against anything that furthered or promoted Westview's sale to Sheldrake. See Pail Aff. at ¶10. As soon as WTI reluctantly agreed to support the continuation of warehousing at Westview, it immediately informed DHCR of its position and asked DHCR to "temporarily suspend its requirement that Westview rent its vacant apartments." See Hirschhorn Aff, Ex. 3 at 3. This action is not remotely comparable to the secret, unilateral, self-serving and illegal warehousing NTIII's Owners/Directors unilaterally commenced in February 2004 and continued to support until after February 2, 2007. See Ex. I at 2. WTI merely asked DHCR to temporarily suspend its own rules so a deal to preserve Westview's affordable housing for all its residents could be pursued. Unlike the actions of NTIII's Owners/Directors, making such a request is not even unlawful. WTI never had the power to commence, continue or terminate the warehousing at Westview; only NTIII (and DHCR) had that power.

When it analyzed its potential claim against the Owners/Director and whether the doctrine of unclean hands would apply to the tenants' last-minute support for the warehousing at Westview, DHCR had the following critical facts before it: (1) the warehousing at Westview was initiated by NTIII's Owners/Directors, who directly and indirectly profited from the warehousing under its sales agreement with Sheldrake, (2) NTIII's warehousing went on for a total of 36 months, and (3) WTI was, at most, partially responsible for only the last 4 ½ months of the warehousing, after it was coerced into supporting its continuance. Nevertheless, DHCR decided to use the tenants' *de minimus* involvement in the warehousing to fully exonerate NTIII's Owners/Directors from any financial responsibility for the warehousing losses at Westview. This conclusion by DHCR, which it continues to assert before this Court, see McCurnin Aff. ¶33, is so nonsensical and so plainly arbitrary and capricious that it raises serious questions about DHCR's motives with respect to the entire 2008 BRD. Something does not seem quite right.

6. DHCR's Other Attempts To Excuse It Failure To Take Legal Action Against NTIII's Owners/Directors Are Unpersuasive

In addition to the arguments discussed above, DHCR also attempts to avoid its responsibility under §91 to take action against the Owners/Directors to recoup Westview's lost warehousing income by arguing that (1) any money DHCR attempts to secure from the Owners/Directors would be considered a new infusion of equity into the building, which DHCR cannot order, see DHCR Mem. of Law at 6, (2) there is no source of Housing Company funds from which DHCR could get the lost money, see id,. and (3) housing company expenses can only be paid from housing company earnings. See id. at 7.

DHCR's argument that seeking to recoup the warehousing losses at Westview from the Owners/Directors is akin to requiring an additional investment of equity in the building completely ignores the point that if not for the Owners'/Directors' intentional unlawful conduct – which DHCR itself recognizes occurred – Westview would have $1,000,000 in additional income and a rent increase to would not be necessary. Seeking to recoup this money is hardly akin to requiring an innocent party to make an additional investment in a building

That DHCR understands this distinction is undeniable in light of its recent amendments to its own regulations, which expressly allow DHCR to recoup income lost to warehousing.[52] Do these new regulations provide DHCR with a new mechanism for securing an additional investment of equity in Mitchell-lama buildings? Of course not. The new regulations, as with the lawsuit DHCR was required to bring against with respect to NTIII's Owners/Directors under §91, allows DHCR to recoup the Owners'/Directors' ill-gotten gains in an amount equal to the income their warehousing deprived Westview. DHCR's "investment of equity" defense simply does not hold water.

DHCR's other two defenses – that there is no source of Housing Company funds from which they could get the lost money and that housing company expenses can only be paid from housing company earnings – are equally unavailing. Westview's Housing Company, although it directly implemented the warehousing, did so pursuant to the direction of and exclusively to benefit the Owners/Directors who controlled it. As the lost warehousing income would be recouped from the persons who caused the unlawful warehousing to occur at Westview – the Owners/Directors – it is irrelevant that the Housing Company does not have the funds to pay for

[52] See 9 NYCRR §§1729-1.5(a)(13), (14).

the warehousing losses.[53] In fact, the Housing Company would be the beneficiary of the recouped funds, not the source of them.

The absurdity of DHCR's argument that housing company expenses can only be paid from housing company income, even in the case of unlawful acts or third-party liability, is made obvious through a simply, hypothetical fact pattern: If someone were to intentionally drive their car through the front wall of Westview, and Westview needed to repair the damaged wall, according to DHCR's position, Westview could not sue the driver and attempt to collect money for the repairs from the driver's insurance company because that would constitute an attempt to pay a Westview expense with non-Westview income. The fact that DHCR would assert this position, especially in light of the fact that the warehousing loss was caused by an intentional unlawful act, reflects the bizarre length DHCR has gone to avoid having to take legal action against the Owners/Directors.

7. The Proper Remedy For NTIII's Owners'/Directors' Unlawful Warehousing Is For This Or A Future Court To Disgorge $1,036,364 Of Their Improper Warehousing Profits And Order They Be Used To Restore The *Status Quo Ante* At Westview

This Court should find, and order DHCR to conclude, that NTIII's Owners/Directors are personally liable for the $1,036,364 in income Westview lost to warehousing. The fact that the WTI was coerced into providing 4 ½ months of *de minimus* support for the warehousing by a party with far greater bargaining power is not enough, under the law, to preclude a full recovery of the warehousing losses from the Owners/Directors.

[53] As noted, *supra*, the Housing Company has $1.1 million in a reserve fund, so DHCR's claim that it does not have any excess funds is as inaccurate and it is irrelevant. See Freedman Aff. ¶7. See also Admin. R., A-17 at 8.

In the alternative, this Court could order DHCR to apportion fault for the warehousing and to hold the Owners/Directors responsible for their proper portion of the damages. Apportionment of fault here is an easy exercise. DHCR should conclude the Owners/Directors are solely responsible for the warehousing that occurred before WTI agreed to support it as well (i.e. for the first 31 ½ months, or 87.5% of the total time warehousing occurred). Once WTI agreed to support the continuation of the warehousing, DHCR should hold the Owners/Directors responsible for no less than 50% of the warehousing losses and the tenants responsible for no greater than 50% of the losses, in light of their unequal bargaining power and the fact that only the Owners'/Directors' had control over the building and only their actions were unlawful. At most, this would assign the Owners/Directors and WTI an equal 50% responsibility for the last 4 ½ months of warehousing (i.e. 12.5% of the total, or 6.25% each). This formula would hold the Owners/Directors responsible for 93.75% of the warehousing losses, and the tenants responsible for 6.25% of the losses.

Applying these figures to the $1,036,364 in lost income the warehousing caused at Westview, the Owners/Directors would be personally liable to pay $971,591.25 in damages to the Housing Company, which would be ordered to use the funds to offset expenses at Westview and thereby decrease/eliminate the need for a rent increase; the tenants, for their part, would be responsible for paying $64,772.75 in damages. The tenants' share of the losses would be paid by adding the $64,772.75 as an expense in Westview's budget for the 2008 BRD, because that expense would be paid out of rents collected from the tenants.

Having found the Owners/Directors were unjustly enriched by their unlawful conduct, and that, as intended, it produced millions of dollars of improper profits for them personally, the specific basis for the recovery of their ill-gotten gains under the law is the remedy of restitution.

"The object of restitution is to restore the *status quo ante* – to put the parties back into the position they were in before the unjust enrichment occurred." New York City Econ. Dev. Corp., 2006 N.Y. Slip Op. at *3, 11 Misc.3d at __, 819 N.Y.S.2d at __. Such a result can only be accomplished by having the $1,036,364 in rental income Westview lost to warehousing restored from the personal funds of the Owners/Directors who ordered and benefitted from it. This $1,036,364 could either be awarded by the Court here, or could come pursuant to an order of this Court that DHCR pursue legal action to recover the lost $1,036,364 from the Owners/Directors in a separate legal action. In either event, this Court should order DHCR to immediately eliminate the portion of the rent increase that was necessary to cover the $1,036,364 in lost revenue/increased expenses caused by the warehousing. In short, this order would reduce the rent increase to $0.

In summary, DHCR had the ability and obligation to sue the Owners/Directors to recoup the $1,036,364 in income they unlawfully deprived Westview through their unlawful warehousing of apartments, yet it took no action against them. DHCR even went to the trouble of calculating the precise damages caused by the warehousing, see Admin. R., A-15 at 1, but then ignored its own calculations when analyzing the 2008 BRD's rent increase application. Both of these failures to act were, as a matter of law, arbitrary and capricious. See In re Merber v. Urstadt, 46 A.D.2d 752, 753, 360 N.Y.S.2d 685, 687 (1st Dept. 1974).

What is worse about DHCR's arbitrary and capricious behavior here, is that it is part of a long-time pattern and practice of DHCR failing to hold owners accountable when they violate Mitchell-Lama laws and instead opting to pass the costs of their unlawful acts on to tenants. As New York State Inspector General Kristine Hamann wrote on September 19, 2007, "Rather than safeguarding the integrity of the [Mitchell-Lama] program, DHCR, through its own

shortcomings, allowed housing companies to flout rules regarding apartment allocation, financial reporting, and contracting. DHCR's deep and systemic failures resulted in increases in charges to tenants[54]. . . ." See New York State Inspector General Kristine Hamann, "Press Release", Sept. 19, 2007 at 1 (emphasis added), a true and correct copy of which is attached as Exhibit J. This Court should put DHCR on notice that the continuation of this pattern and practice will no longer be tolerated by the courts of the State of New York.

C. THE COURT SHOULD ORDER DHCR TO HOLD NTIII'S OWNERS/DIRECTORS LIABLE FOR WESTVIEW'S WAREHOUSING LOSSES AND ORDER THEM TO PAY THE HOUSING COMPANY $1,036,364 IN RESTITUTION PURSUANT TO 9 NYCRR §§1729-1.5(A)(13), (14)

Alternatively, this Court could order DHCR to hold NTIII's Owners/Directors personally liable for the $1,000,000 in income Westview lost to the unlawful warehousing they instituted for their own personal benefit, pursuant to 9 NYCRR §§1729-1.5(a)(13), (14), which reads,

> If the division determines at any time that a housing company, its officers, directors, employees, agents, managing agent or project management of a self managed company have failed to comply with its agreements, these regulations, or division directives of if they are failing to or threatening not to do that which is required by law or regulation, the division may . . . with respect to warehousing as defined in section 1727-1.5, directors, managing agents, or housing company employees may be held liable to the housing company for any rent losses incurred, and; . . . subject the individuals or entity to such orders, directives, penalties, or remedies as are otherwise provided or allowed by law.

As §§1729-1.5(a)(13), (14) does not require DHCR institute court action to hold the Owners/Directors liable for the $1,000,000 in warehousing losses or to order them to pay restitution to the Housing Company, this remedy can be effectuated immediately. As such, at the same time as it orders the Owners/Directors to pay for the lost $1,000,000 in rental income,

[54] Accord Ex. E at 1-2 (DHCR Commissioner admitting warehousing leads to increased rents for tenants).

DHCR should adjust the 2008 BRD rent increase to reflect the $1,000,000 in income the Housing Company will receive from its Owners'/Directors..

Although the new regulation says DHCR "may" bring an action against the Housing Company and its Directors (and in this case, through veil piercing, against its owners as well. See Part II.B.3.c, *supra*), it would be arbitrary and capricious for DHCR not to do so. DHCR has already concluded that the Owners/Directors instituted and maintained illegal vacancies at Westview and that the warehousing deprived Westview of $1,065,777 in income. See Part II.A, *supra*. As such, a decision by DHCR to continue to force the tenants to pay for the warehousing losses through a rent increase, in light of the fact that they now have the authority and ability to recoup those losses directly from NTIII's Owners/Directors, would unquestionably constitute an arbitrary and capricious decision which lacks a "basis in reason and is . . . taken without regard to the facts." See Pell, 34 N.Y.2d at 231, 313 N.E.2d at 325, 356 N.Y.S.2d at 839. This is especially true in light of the fact that the warehousing directly led to a sales agreement that produced $4,000,000 in improper profits for the Owners/Directors as well as $500,000 in additional compensation linked directly to the amount of the warehousing losses. See Part II.A, *supra*.

In DHCR's supplemental answer in this action, see Letter from DHCR Principal Attorney Sheldon Melnitsky to David B. Hirschhorn, Esq. and Chad A. Marlow, Esq., dated December 21, 2009 ("DHCR Supplemental Answer"),[55] DHCR claims it cannot apply §§1729-1.5(a)(13), (14) to recoup Westview's warehousing losses from the Owners/Directors. DHCR goes on to state that even if it were able, as a matter of law, to use §§1729-1.5(a)(13), (14) to recoup Westview's

[55] DHCR, with the consent of Petitioners and NTIII, requested the DHCR Supplemental Answer be treated as part of its opposition papers in this action. See Letter from DHCR Associate Attorney John Stellar to Hon. Alice Schlesinger, dated January 22, 2010.

warehousing losses from the Owners/Directors, the sole reason it would not do so is because "as a factual matter, this particular situation would not be the kind of case where DHCR would exercise such discretionary enforcement authority, as Petitioners were also involved in the warehousing of apartments that occurred at Westview." DHCR Supplemental Answer at 2. Both of these decisions are patently arbitrary and capricious.

Here again, DHCR's legally infirm application of the unclean hands doctrine fails to support its decision not to proceed against the Owners/Directors based upon WTI's *de minimus*, eleventh hour acquiescence to the continuation of warehousing at Westview. See Part II.B.5, *supra*. DHCR admits that the only reason it would not use §§1729-1.5(a)(13), (14) against the Owners/Directors, if it was legally allowed to do so, is because of WTI's alleged unclean hands. Consequently, because the application of the unclean hands doctrine in this case is entirely improper, if DHCR was allowed as a matter of law to use §§1729-1.5(a)(13), (14) against the Owners/Directors, DHCR itself concedes that decision not to do so would lack justification. Such would be the very definition of an arbitrary and capricious decision. As a practical matter, this means that if DHCR can use §§1729-1.5(a)(13), (14) to recoup Westview's warehousing losses from the Owners/Directors, this Court should order it to do so.

It is, however, DHCR position that not only are they barred from using §§1729-1.5(a)(13), (14) against the Owners/Directors, but that this Court is barred from ordering them to do so because, "in reviewing an administrative decision, courts look to the law as it existed at the time that the determination was rendered." DHCR Supplemental Answer at 2. This inaccurate statement of the law is the result of an overly simplistic analysis of the rules governing the retroactive application of new laws and statutes, and is based on three cases that are factually incongruent with an analysis of §§1729-1.5(a)(13), (14)'s potential retroactivity. In fact, all of

the cases cited by DHCR, in which new laws/rules were held not to apply retroactively, involved the implementation of an entirely new rule or standard or a substantive change to an existing standard.[56] As discussed, *infra*, these types of new statutes/regulations are typically not applied retroactively unless the statute specifically says otherwise. However, the effect of the new DHCR regulations at issue here, and the way such regulations are treated with respect to retroactivity, is very different from those in the cases cited by DHCR.

In order to determine whether DHCR's new regulations at §§1729-1.5(a)(13), (14) can be applied retroactively to empower DHCR to hold NTIII's Owners/Directors liable for the losses their warehousing caused Westview, this Court needs to specifically analyze §§1729-1.5(a)(13), (14) under the laws governing retroactivity. This is not, as DHCR suggests, a simple exercise in saying that new regulations do not apply retroactively.[57] To the contrary, as the United States Supreme Court observed, the law governing "when a statute [or regulation] operates 'retroactively' is not always a simple or mechanical task." Landgraf v. USI Film Prods., 511 U.S. 244, 268 (1994). Nevertheless, the rules governing retroactivity can be distilled down to

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[56] See In re Peckham v. Calogero, 12 N.Y.3d 424, 911 N.E.2d 815, 883 N.Y.S.2d 751 (N.Y. 2009) (changing the standard of what constitutes a "demolition"); In re Classic Realty, 298 A.D.2d 201, 748 N.Y.S.2d 148 (establishing a new rule that when a housing condition exists for more than four years before a complaint is made, such is proof the condition is *de minimus*); In re Waverly Place Assocs. v. New York State Div. of Hous. & Cmty. Renewal, 292 A.D.2d 211, 739 N.Y.S.2d 372 (1sr Dept. 2002) (establishing a new form of evidence that can be submitted in fair market appeals); Murphy v. Board of Edu., 104 A.D.2d 796, 48- N.Y.S.2d 138 (2nd Dept. 1984) (changing the duration laid off teachers hold preferred status in hiring from four to seven years).

[57] DHCR's adoption of this position is also surprising in light of its past willingness to apply new rules that went into effect in the middle of its own administrative hearings. DHCR has even sought and received judicial affirmation of that policy. See In re St. Vincent's Hosp. & Med. Center of N.Y. v. New York State Div of Hous. & Cmty. Renewal, 109 A.D.2d 711, 712, 487 N.Y.S. 36, 37 (1st Dept. 1985) ("Where a statute has been amended during the pendency of a proceeding, the application of that amended statute to the pending proceeding is appropriate and poses no constitutional problem.").

some basic principles. See generally Geoffrey C. Weien, "Retroactive Rulemaking", 30 Harvard J. L. & Pub. Pol'y 749 (2007).

With respect to when the retroactive application of a new statute of regulation is improper, the law is fairly straightforward. When a new statute or regulation "changes the rules of the game" by announcing new standards or requirements that alter the vested rights of those it impacts, it will not be applied retroactively. See Landgraf, 511 U.S. at 269-70 ("The presumption against statutory [or regulatory] retroactivity has consistently been explained by reference to the unfairness of imposing new burdens on persons after the fact.") Put another way, the proper question for a court to ask in making a retroactivity determination is "have those the law would affect adjusted their behavior based in reliance on the original standard or requirement so that they have developed a protected interest in the status quo?" See Orr v. Hawk, 156 F.3d 651, 654 (6th Cir. 1998).

While changing the rules of the game going forward is always permissible, courts will not allow those who have relied on the law to be found to have violated a new standard that did not exist at the time they were attempting comply with the old one. See generally Landgraf, 511 U.S. at 265 ("individuals should have an opportunity to know what the law is and to conform their conduct accordingly."). In short, the law focuses on the issue of fair notice to ensure that parties whose behavior is consistent with the former rules do not find themselves accused of violating new ones based on their previously lawful behavior.

Despite the existence of well-established rules concerning when retroactively applying a new statute or regulation is improper, such prohibitions are not universal. In fact, the United States Supreme Court has noted that "[a]lthough we have long embraced a presumption against

statutory [and regulatory] retroactivity, for just as long we have recognized that, in many situations, a court should apply the law in effect at the time it renders its decision, even though that law was enacted after the events that gave rise to the suit." Landgraf, 511 U.S. at 273 (internal quotation and citation omitted). In the case at bar, three of the categories of new statutes and regulations that can and should be applied retroactively are relevant.

The first category of permissible retroactivity applies to new statutes and regulations that do not alter the existing rules. As the United States Supreme Court has recognized,

> A statute [or regulation] does not operate "retrospectively" merely because it is applied in a case arising from conduct antedating the statute's [or regulation's] enactment or upsets expectation based in prior law. . . . The conclusion that a particular rule operates "retroactively" comes at the end of a process of judgment concerning the nature and extent of the change in the law and the degree of connection between the operation of the new rule and a relevant past event.

Landgraf, 511 U.S at 269-70 (internal citation omitted). The Landgraf court went on to explain that a law or regulation that does not "take[] away or impair[] vested rights acquired under existing laws, or create[] a new obligation, impose[] a new duty, or attach[] a new disability, in respect to transaction or considerations already past" can be applied retroactively. Landgraf, 511 U.S. at 269 quoted in Orr, 156 F.3d at 654. Understanding that courts may shy away from applying new laws and regulations retroactively, the Supreme Court reminded judges that they should not hesitate to apply new statutes and regulations retroactively where they believe doing so is proper, because "retroactivity is a matter on which judges tend to have sound instincts, and familiar considerations of fair notice, reasonable reliance, and settled expectations offer sound guidance." Landgraf, 511 U.S. at 269-70 (internal citation omitted).

This Court should not hesitate to conclude that DHCR's new regulations did not alter the existing rules that are applicable in this action. §§1729-1.5(a)(13), (14) clearly falls within this

first category because it does not in any way alter the existing rules applicable to Mitchell-Lama housing companies. DHCR itself publicly stated, before the new regulations were adopted, that warehousing was unlawful under the existing Mitchell-Lama law and regulations. See Ex. C, E. §§1729-1.5(a)(13), (14) does not alter that rule in any way.

The second category of permissible retroactivity applies to new statutes and regulations that clarify an existing rule. With respect to this category, the rule governing retroactivity is that "even [where a party] has a protected interest, the amended regulation might properly apply . . . as a clarifying rule. So long as a change in a regulation does not announce a new rule, but rather merely clarifies or codifies an existing policy, that regulation can apply retroactively." Orr, 156 F.3d at 654. As is the case with DHCR's new warehousing regulations,

> A rule clarifying an unsettled or confusing area of the law "does not change the law, but restates what the law according to the agency is and always has been: 'It is not more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand.'"

Orr, 156 F.3d at 654 (quoting Pope v. Shalala, 998 F.2d 473, 483 (7th Cir. 1993), quoting Manhattan Gen. Equip. Co. v. Commissioner, 297 U.S. 129, 135 (1936)). Accord In re Versailles Realty Co. v. New York State Div. of Hous. & Cmty. Renewal, 76 N.Y.2d 325, 330, 558 N.E.2d 1009, 1011, 559 N.Y.S.2d 472, 474 (N.Y. 1990); Appalachian States Low-Level Radioactive Waste Comm. v. O'Leary, 93 F.3d 103, 113 (3rd Cir. 1996).

This rule more precisely applies to the portion of the new regulations found at 9 NYCRR §1727-1.5. That regulatory provision, entitled "Warehousing", specifically states that "[i]t is the obligation of a housing company to promptly fill vacant apartments for occupancy with eligible tenants from the housing company's waiting lists in accordance with this chapter." This is nothing more than a clarification of the pre-existing rule that warehousing was unlawful.

Compare § 1727-1.5 with Ex. E at 1 ("Although DHCR's regulations do not specifically cover the failure to re-rent units as they become vacant, the necessity of doing so is implicit from the entire regulatory structure.").

The third category of permissible retroactivity applies to new statutes and regulations that enable an agency to better enforce the existing rules or better respond to a violation of them (i.e. a change to procedural rules). The United States Supreme Court has specifically noted that changes to procedural rules – such as providing how an agency can respond to the violation of an existing rule – generally are applied retroactively. As Landgraf Court noted,

> Changes in procedural rules may often be applied in suits arising before their enactment without raising concerns about retroactivity. . . Because rules of procedure regulate secondary rather than primary conduct, the fact that a new procedural rule was instituted after the conduct giving rise to the suit does not make application of the rule at trial retroactive.

Landgraf, 511 U.S. at 275. See also In re Marino S., 100 N.Y.2d 361, 370-71, 795 N.E.2d 21, 26, 763 N.Y.S.2d 796, 801 (N.Y. 2003) ("Ameliorative or remedial legislation . . . should be given retroactive effect in order to effectuate its beneficial purpose.").

This is precisely what §§1729-1.5(a)(13), (14) was designed to accomplish. §§1729-1.5(a)(13), (14) did not announce new rules or alter rules regarding warehousing. Rather, §§1729-1.5(a)(13), (14) seeks only to provide an expedited way for DHCR to hold persons accountable for violating existing anti-warehousing laws and regulations.[58] As such, §§1729-1.5(a)(13), (14) presents an ideal example of when a new regulation should be applied

[58] DHCR, in taking a no-retroactivity position here, essentially argues that applying §§1729-1.5(a)(13), (14) to NTIII's Owners/Directors would be inappropriate because they were relying on the fact that they could break the law and get away with it. This unavailing argument actually serves to illustrate why the retroactive application of new, remedial regulations such as §§1729-1.5(a)(13), (14) is sanctioned by the courts.

retroactively. See In re Marino S., 100 N.Y.2d at 371, 795 N.E.2d at 26, 763 N.Y.S.2d at 801 ("Because the [regulation] is remedial in nature and does not impair vested rights, it should be applied retroactively.")

Accordingly, this Court should hold that §§1729-1.5(a)(13), (14) applies retroactively to provide a means for DHCR to recoup the losses caused by the Owners'/Directors' warehousing, which was unlawful prior to the institution of DHCR's new regulations. In addition, the Court should order DHCR to take any and all necessary action under §§1729-1.5(a)(13), (14) to recoup the $1,036,364 in income Westview lost to warehousing from NTIII's Owners/Directors.

CONCLUSION

For the reasons set forth herein, Petitioner Westview Taskforce, Inc. respectfully requests that the Court find in favor of the Petitioners in this Article 78 action and grant the following relief: (1) order DHCR to remove the $163,800 allocated for debt service arrears funding from Westview's 2008 BRD budget and to adjust the rent increase accordingly; (2) order DHCR to recoup Westview's $1,036,364 in income lost to warehousing from NTIII's individual Owners/Directors, either pursuant to N.Y. Priv. Hous. Fin. Law §91(1) or 9 NYCRR §§1729-1.5(a)(13), (14); (3) order DHCR to reverse its arbitrary and capricious decision to increase tenants' rents to pay for the $1,036,364 in lost warehousing income[59] and to adjust the rent increase accordingly; and (4) such other and further relief as the Court may deem just and proper.

Dated: February 2, 2010

Respectfully Submitted,

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[59] Either by ordering DHCR to adjust the second year of Westview's 2008 BRD budget to reflect $1,000,000 more in income or $1,000,000 less in expenses.

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