Contello Towers II Corp. v City of New York
2008 NY Slip Op 32866(U)
October 17, 2008
Supreme Court, Kings County
Docket Number: 0039422/2005
Judge: Karen B. Rothenberg
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At an IAS Term, Part 22 of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, at Civic Center, Brooklyn, New York, on the 17th day of October, 2008.

P R E S E N T:

HON. KAREN ROTHENBERG,

Justice.

- -X

CONTELLO TOWERS II CORP.,

Plaintiffs,

- against -

Index No. 39422/05

CITY OF NEW YORK, et ano,

Defendants.

- -X

The following papers numbered 1 to 6 read on this motion:

	Papers Numbered
Notice of Motion/Order to Show Cause/ Petition/Cross Motion and Affidavits (Affirmations) Annexed	1 - 4
Opposing Affidavits (Affirmations)	
Reply Affidavits (Affirmations)	5 - 6

Upon the foregoing papers, defendants the City of New York (the City) and the Department of Housing Preservation and Development of the City of New York (HPD) move for an order, pursuant to CPLR 3212, dismissing the complaint of plaintiff Contello Towers II Corp. (Contello) in its entirety.

Plaintiff, the owner of a Mitchell-Lama cooperative development, commenced this action seeking to rescind a Non-Dissolution Rider pursuant to which it agreed to remain in the Mitchell-Lama Program for at least twenty years from the date of the closing of a loan in the amount of $1,996,722 (the loan), contending that it was coerced into agreeing to it.

In 1998, Contello applied to the City, through HPD, for a subsidized rehabilitation loan, pursuant to Private Housing Finance Law Article VIII-A. In 2000, HPD approved the loan at an

interest rate of 3% to finance the replacement of 2,332 windows, the renovation of four elevators and to do pointing work to prevent leaking. As a condition to receiving the loan, plaintiff was required to sign the Non-Dissolution Rider. The parties closed on the loan on May 11, 2000, the proceeds were advanced and the work was fully performed during the summer of 2002.

In its complaint, Contello alleges that HPD improperly made the loan "amid serious allegations of corruption and fraud among certain former directors of the cooperative which ultimately lead to the criminal conviction and resignation of board members and employees of the managing agent." Plaintiff alleges that HPD refused to investigate and nonetheless approved the loan, handing almost two million dollars to the individuals that the Board members accused of corruption, without the approval of the shareholders.

Further, at the closing, Donald Sternberg, the Board's president, was presented with many documents, including the Non-Dissolution Rider, and was told that if he did not sign them, Contello would not get the loan. Plaintiff contends that neither Sternberg nor his attorney was given the opportunity to review the Non-Dissolution Rider prior to closing, the Rider was not explained to Sternberg and Sternberg was not told that the Rider would result in Contello not having the right to withdraw from the Mitchell-Lama Program for 20 years.

Defendants argue that plaintiff's action should be precluded based upon the ground of laches. Moreover, plaintiff does not offer to restore to the City the benefits that it received pursuant to the subsidized loan, and seeks only to rescind the Non-Dissolution Rider. Defendants argue that plaintiff's acceptance of the benefits of the loan for five years after learning of the alleged fraud constitutes ratification, thereby making rescission unavailable and that plaintiff was not coerced into entering into the loan transaction, since it had a full and fair opportunity to review the terms of the agreement with experienced counsel, Irwin Fingerit.

Defendants also submit an affidavit from Roger Ho in which he alleges that he is employed by HPD and has been the Director of the 8A Loan Program since September 1998. Ho alleges that in September 1998, Contello submitted an application for an 8A loan, which included a condominium plan indicating that Contello sought to go private. Since market rate condominiums generally would not qualify for an 8A loan, HPD wanted an assurance from Contello that it did not intend to leave the Mitchell-Lama Program. Accordingly, by letter dated December 1, 1998, Fingerit confirmed that "Contello has no intention of leaving the Mitchell-Lama Program." HPD, via its inspectors, confirmed that the window work was completed by October 9, 2001, the facade work by

November 9, 2001 and the elevator work by June 28, 2002.

Defendants also annex an affidavit from Joseph Arata, who was employed as an attorney in the Office of Legal Affairs for HPD who worked on the loan. Arata alleges that the mortgage included a Non-Dissolution Rider, which required Contello to remain in the Mitchell-Lama Program for 20 years. Further, according to its terms, Contello could not prepay the note during the 20-year term of the mortgage. By opinion letter dated May 3, 2000, Fingerit acknowledged that he reviewed the loan documents and all actions of Contello had been duly authorized. Arata further testified that at the closing, Contello was represented by Fingerit and during the closing, Sternberg initialed the Non-Dissolution Rider, which was an attachment to the mortgage.

Defendants also rely upon the deposition testimony of Fingerit to establish that plaintiff was aware, both before and during the closing, that the loan would be conditioned upon plaintiff agreeing to the Non-Dissolution Rider. Fingerit attended several Board and shareholder meetings where he told shareholders that if they planned to remain in the development, they should be in favor of the 8A loan because it would keep maintenance payments low; if they planned to sell their apartment, they should be in favor of going private, in the hope of getting a higher price. He did not feel that HPD exerted any undue pressure on his client and that every Mitchell-Lama loan that he closed had the same provision to remain in the program. Fingerit explained that in order to obtain an 8A loan, the Board would have to vote to apply.

Defendants also rely upon the deposition testimony of Sternberg, who became a member of the Board in 1997; and a year later, was elected president. While Sternberg was president, the Board voted unanimously to apply for an 8A loan. Four months after the closing, Sternberg resigned from the Board. He recalled receiving a letter from HPD, dated May 22, 2000, that was put under the doors of all of the residents; advising that Contello received a loan in the amount of $1,996,772 at 3% interest and that as a condition to receiving the money, the development would not be able to prepay the loan or to convert to private ownership through May 2020.

In opposition to the motion, plaintiff contends that HPD knew that the District Attorney was investigating a board member at the time of the closing, and that HPD's motive for proceeding with the loan was to perpetrate its own existence, since over one-third of the units in the City's Mitchell-Lama Program withdrew between 1990 and 2006.

Plaintiff also argues that it was fraudulently induced and coerced into signing the Non-Dissolution Rider and that the Rider is procedurally unconscionable and that HPD should be

estopped from enforcing the Rider, since it was aware of the corrupt acts, but lent plaintiff the money anyway; a majority of the shareholders want to exercise their statutory right to opt out of the Mitchell-Lama Program; the loan would have to be repaid as a condition to withdrawing; and plaintiff relied upon HPD, as a supervisory government entity, when it agreed to the mortgage. Finally, plaintiff contends that the Non-Dissolution Rider constitutes an unconstitutional taking of their property.

In the first cause of action, plaintiff contends that defendants breached their fiduciary duty to Contello and its shareholders, and therefore defendants should be estopped from enforcing the Non-Dissolution Rider. "In order to establish a breach of fiduciary duty, a plaintiff must prove the existence of a fiduciary relationship, misconduct by the defendant, and damages that were directly caused by the defendant's misconduct" (*Kurtzman v Bergstol*, 40 AD3d 588, 590 [2007], citing *Ozelkan v Tyree Bros. Envtl. Servs.*, 29 AD3d 877, 879 [2008]).

Further, "It is well settled that 'estoppel cannot be invoked against a governmental agency to prevent it from discharging its statutory duties'" (*Matter of Schorr,* 10 NY3d at 779 [citations omitted]). Estoppel may apply only "where a governmental subdivision acts or comports itself wrongfully or negligently, inducing reliance by a party who is entitled to rely and who changes his position to his detriment or prejudice" (*Bender v New York City Health & Hosps. Corp.*, 38 NY2d 662, 668 [1976]). "'[O]nly a showing of fraud, misrepresentation, deception, or similar affirmative misconduct, along with reasonable reliance thereon, will justify the imposition of estoppel'" (*Concerned Port Residents Comm. v Incorporated Vill. of Sands Point*, 291 AD2d 494, 495-496 [2002], quoting *Yassin v Sarabu*, 284 AD2d 531 [2001]; *DeGori v Long Is. R.R.*, 202 AD2d 549 [1994]; *Simcuski v Saeli*, 44 NY2d 442 [1978]).

HPD possesses authority to regulate Mitchell-Lama properties and tenants and to oversee contracts, however, that does not support the conclusion that the City and HPD owe a fiduciary duty to the Board and/or to each shareholder (*cf. Auerbach v Bennett*, 47 NY2d 619, 633 [1979]. Contello has a Board of Directors and a managing agent who oversee its affairs. In addition, it was represented by experienced real estate counsel throughout the loan procedure. Plaintiff has made no showing that demonstrates that it had any reason to expect that a confidential or fiduciary relationship existed between it and HPD or the City.

Plaintiff cites no provision of the Private Housing Finance Law or of the regulations of HPD that would impose upon defendants the obligation to investigate complaints of improper conduct

before loaning funds. In addition, HPD monitored the release of funds and insured that funds were paid to the contractors only after the work was completed. Although plaintiff also argues that defendants should have continued to supervise the money paid to the contractors to insure that no kick backs were paid, it points to no legal precedent or statutory authority that would require or allow HPD to continue to monitor private funds to prevent the commission of a subsequent crime, nor does it suggest any reasonable way to implement such a duty.

Furthermore, the evidence and testimony establishes that inasmuch as the Board had recently voted against going private and advised HPD that it did not intend to do so, plaintiff cannot successfully argue that it was prejudiced in any way by the Non-Dissolution Rider.

Accordingly, the first cause of action, premised upon defendants' alleged breach of fiduciary duty, is dismissed.

In its second cause of action, plaintiff alleges that by ignoring the complaints of shareholders, failing to conduct an investigation and failing to obtain shareholder consent to enter into the Non-Dissolution Rider, HPD has unclean hands, and should be estopped from enforcing the terms of the Non-Dissolution Rider.

"'The doctrine of unclean hands applies when the complaining party shows that the offending party is guilty of immoral, unconscionable conduct and even then only when the conduct relied on is directly related to the subject matter in litigation and the party seeking to invoke the doctrine was injured by such conduct' (*Kopsidas v Krokos*, 294 AD2d 406, 407 [internal quotation marks omitted])" (*Columbo v Columbo*, 50 AD3d 617, 619 [2008]).

The court finds that defendants are not guilty of immoral or unconscionable conduct. Moreover, the corruption that was ultimately established is not "directly related to the subject matter in litigation," since plaintiff fails to establish any nexus between the corruption and defendants' policy decision to require plaintiff to remain in the Mitchell-Lama Program for 20 years in consideration for receiving a low interest loan.

Accordingly, defendants are granted summary judgment dismissing plaintiff's second cause of action.

Plaintiff's third and fourth causes of action are premised upon fraud and unconscionability, and are so closely related, they will be discussed together.

Plaintiff argues that the Non-Dissolution Rider must be rescinded as grossly unreasonable and unconscionable and that the Rider is procedurally unconscionable as plaintiff did not learn of

the requirement until the day of the closing, which resolution was not agreed to by or discussed with the Board or shareholders.

Plaintiff further alleges that defendants forced and coerced plaintiff to sign the Non-Dissolution Rider as a non-negotiable condition of the 8A loan at the last minute, so it was agreed to under duress and at that plaintiff had no meaningful choice. "In general, an unconscionable contract has been defined as one which is so grossly unreasonable as to be unenforceable because of an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party" (*King v Fox*, 7 NY3d 181, 191 [2006], citing *Gillman v Chase Manhattan Bank*, 73 NY2d 1, 10 [1988]).

As a threshold issue, the court agrees with defendants' assertion that the Non-Dissolution Rider is not unconscionable. The Mitchell-Lama Program was instituted for the express purpose of offering private housing companies the incentive to develop low and moderate income housing and that the Program does so by offering long-term, low interest government mortgages and real estate tax exemptions in return for an agreement to abide by regulations concerning rent, profit, disposition of property and tenant selection (*see e.g. Matter of Schorr*, 10 NY3d at 777). Further, covenants pursuant to which a development has agreed to remain in the Mitchell-Lama Program for as long as 50 years have been upheld (*see e.g. Branford House*, 81 NY2d at 684; *Columbus Park*, 80 NY2d 27; *Tivoli Stock*, 50 AD3d 572).

Hence, plaintiff fails to refute defendants' prima facie showing that the Non-Dissolution Rider is not unconscionable by establishing that it was "unreasonably favorable" to defendants. Accordingly, the Non-Dissolution Rider was a vital element of the agreement to make the loan to Contello, and severance of the clause would not be appropriate. Finally, plaintiff received a significant benefit from the transaction at issue, i.e., it received a loan of almost $2,000,000 at the below market interest rate of 3%. Accordingly, any argument that the Non-Dissolution Rider is unconscionable as a matter of law must fail.

The court also rejects plaintiff's attempt to avoid its contractual obligation by arguing that execution of the Non-Dissolution Rider was procedurally unconscionable. In this regard, plaintiff's assertion that Sternberg was not a sophisticated business person is found to be self-serving and unpersuasive. Despite this current characterization of Sternberg, he was elected to the governing Board of a 330 unit condominium complex, and was thereafter elected president. It must be presumed that he read the documents that he signed and understood their meaning (*see generally*

Holcomb v TWR Express, 11 AD3d 513, 514 [2004] [a party who executes a contract is presumed to know its contents and to assent to them]; *Saxony Ice Co. v Little Mary's Am. Bistro*, 243 AD2d 700, 701 [1997] [defendant's claims that she neither read nor understood the terms of the agreement, or that she was misled into signing were patently inadequate and failed to constitute an affirmative defense of mistake of fact or of plaintiff's unclean hands as a matter of law]). Sternberg and Contello were represented by counsel throughout the loan application process and at the closing, and counsel testified that he knew that the 8A loan would require plaintiff to remain in the Mitchell-Lama Program for some number of years.

Further, plaintiff does not refute defendants' prima facie showing that HPD did not knowingly and falsely represent to plaintiff that it would receive the 8A loan without signing the Non-Dissolution Rider, so that its claim of fraud also must fail. The letter dated December 1, 1998, at the inception of the loan application process, establishes that Contello did not intend to go private, so the facts do not support a finding that HPD misrepresented that they would make the loan without plaintiff agreeing to remain in the Mitchell-Lama Program for 20 years. Plaintiff does not point to any evidence to establish that thereafter, HPD misrepresented its intentions or otherwise deceived plaintiff into agreeing to that condition. Plaintiff similarly fails to establish reliance. Further, at that time that the loan closed, the shareholders and the Board did not wish to go private, so that the inclusion of the Non-Dissolution Rider as a condition to the loan cannot be said to have resulted in injury.

The court also notes that although plaintiff argues that a corporate resolution was drafted at the closing, the court finds that the second resolution is not inconsistent with the first. More specifically, the first resolution states, in full, that:

> "1. The Corporation will borrow from the City of New York, under the Section VIII-A Loan Program the sum of $1,996,722.00 to be secured by the Corporation's real estate and;
>
> "2. The President of the Corporation is empowered to sign any and all documents necessary therefore."

Since the language in the first resolution made no mention of the terms or conditions of the loan and authorized the President of the Board to sign any and all documents necessary to obtain the loan, it must be concluded that executing the second resolution at the closing was within the authority of the President and was not improper. The plaintiff also offers no evidentiary support for its assertion that if it did agree to the Non-Dissolution Rider at the closing, the loan would not have

been available at a later date.

Even if the Non-Dissolution Rider was found to be unconscionable or if the loan was found to have been obtained by fraud, the court agrees with defendants' claim that it could not be rescinded because plaintiff ratified the agreement and thereby waived any right to rescind, and furthermore, its claim is barred by laches. Even assuming that plaintiff was not aware of the requirements of the Non-Dissolution Rider before the date of the closing, it became aware of the requirements no later than May 11, 2000 and, the individual shareholders were on notice since at least May 22, 2000 that they would not be able to privatize until 2020 as a condition to receiving the loan, as HPD placed a notice under the door of each tenant. Contello thereafter retained contractors to perform the contemplated work and accepted the loan proceeds to pay for the work, thereby ratifying the terms of the loan agreement.

Accordingly, plaintiff's third and fourth causes of action, as predicated upon unconscionability, fraud or coercion, must also be dismissed.

In its fifth cause of action, plaintiff seeks to obtain a declaration that the Non-Dissolution Rider is unconstitutional, alleging that it constitutes an unlawful taking of property without due process of law as is required pursuant to the Fifth Amendment of the United States Constitution.

Plaintiff argues that defendants committed a taking, since the Non-Dissolution Rider deprives the shareholders of their statutory right to dissolve and withdraw from the Mitchell-Lama Program, thereby depriving them of their full use of the property.

In discussing what constitutes a taking, the court has explained that:

> "The Fifth Amendment to the United States Constitution provides 'nor shall private property be taken for public use, without just compensation.' Historically, takings jurisprudence involved instances in which the government encroached upon or occupied real property for public use. Beginning with *Pennsylvania Coal Co. v Mahon* (260 US 393 [1922]), the Supreme Court recognized that, even if the government does not seize or occupy a property, a governmental regulation can work a taking if it 'goes too far' (*id.* at 415)."

(*Smith v Town of Mendon*, 4 NY3d 1, 8-9 [2004])

> "It is clear that not every deprivation of use, possession, or control is a 'taking'. It is the character and extent of an invasion of property rights which are determinative. *United States v Causby*, 328 US 256, 266 [1946]. It is equally clear that not all takings of property are compensable. *See e.g.*, *Houck v Little River Drainage District*, 239

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> US 254 (1915); *General Motors Acceptance Corp. v. United States*, 286 US 49 [1932]. Nor is an interference with the use of property a compensable taking if it is the result of a sovereign act. *See e.g.*, *New Orleans Public Service, Inc. v City of New Orleans*, 281 US 682 (1930); *United States v Carver*, 278 US 294 [1929])."

(*Finks v United States*, 395 F2d 999, 1003-1004 [1968], *cert denied* 393 US 960 [1968]).

It has also been established that:

> "The clear thrust of the authorities is that where the government possesses property under the color of legal right, as by an express contract, there is seldom a taking in violation of the Fifth Amendment. The amendment has limited application to the relative rights in property of parties litigant which have been voluntarily created by contract. *Consolidation Coal Co. v United States*, 60 Ct Cl 608 (1925), *appeal dismissed*, 270 US 664 (1926); *Klebe v United States*, 57 Ct Cl 160 (1922), *affd*, 263 US 188 (1923). *See generally* 2 Nichols, Eminent Domain § 6.1 (3d ed. 1963)."

(*Henry Co. v United States*, 411 F2d 1246 (1969]).

The court declines to hold that defendants' insistence on an agreement that plaintiff remain in the Mitchell-Lama Program for an additional 20 years as a condition to receiving the loan constitutes an unconstitutional taking. Plaintiff knowingly and voluntarily entered into a contract pursuant to which it agreed to remain in the Mitchell-Lama Program for 20 years in return for obtaining a significant benefit in the loan agreement that it executed with HPD, i.e., Contello received a loan of almost $2,000,000 at the below market interest rate of 3%. It is also clear that the shareholders and Board in control of Contello at the time that the loan was made did not wish to withdraw from the program.

The court therefore declines to hold that the inclusion of the Non-Dissolution Rider in the loan agreement constitutes an unconstitutional taking of plaintiff's property.

Defendants' motion for summary judgment dismissing the complaint is granted and the action is dismissed in its entirely.

This constitutes the decision, order and judgment of the court.

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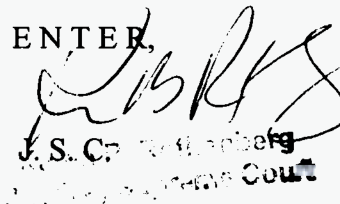

J. S. C.