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Expert Analysis

Enforceability of Board-Adopted Fines and Fees, Revisited

By **Richard Siegler** And **Eva Talel**

Fines and sublet leasing fees are important mechanisms by which co-op and condominium boards encourage compliance with rules and regulations, manage the size of a building's transient rental population, and generate revenue to offset maintenance increases or capital expenditures. However, for these fines and fees to be effective, boards must ensure that courts will not strike them down if challenged by an owner.

This column updates our previous columns dealing with such fines and fees.[1] This column also recaps leading precedents and analyzes recent cases. Lastly, we offer recommendations to boards and managers for maximizing the enforceability of fines and fees.

Co-op Fines and Sublet Fees

For co-op boards to adopt enforceable house rules imposing fines or fees, the proprietary lease must grant the board authority to do so and the house rules must be properly enacted. Further, boards may not circumvent lease provisions imposing specific fines or fees by adopting house rules that change such lease provisions.

For example, in *North Broadway Estates v. Schmoldt*,[2] a shareholder challenged a board adopted house rule imposing a $30 flat fee for late maintenance payments, arguing that because the proprietary lease provided only that late maintenance payments would bear "interest," the house rule imposing a fee improperly contravened the lease's late payment provision. The Civil Court, City of Yonkers, agreed, holding that a house rule may not alter a contractual right under the proprietary lease "to pay the specific type of penalty provided for in the lease for lateness."

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Courts have taken a similar approach to co-op subleasing fees. In the leading case of *Zuckerman v. 33072 Owners Corp.*,[3] the Appellate Division, First Department, upheld a board-imposed sublet fee sourced in a broad and unqualified proprietary lease provision which made subleasing "subject to such conditions as the board may decide to impose." Absent such authorizing provisions, courts have invalidated fees adopted by boards. Thus, even where the proprietary lease granted the board authority to approve or reject subleases, the First Department, in *Zimiles v. Hotel Des Artistes*,[4] held that the proprietary lease must also grant the board authority to either impose a fee or set conditions for approval of subleases; otherwise, board-imposed subleasing fees are unenforceable.

While the foregoing cases were decided in 1990, 1983 and 1995, respectively, our research has failed to disclose any later-decided cases that deviate from the principles established in the foregoing cases.

Most recently, in 2013, in *Cohan v. Board of Directors of 700 Shore Road Waters Edge*,[5] the Appellate Division, Second Department, addressed the importance of due enactment of a board rule, holding that the board improperly imposed a $3,000 sublet fee for alleged illegal subletting by the apartment owners because the board had not formally adopted the sublet fee as a house rule. This, notwithstanding that the owners were on actual notice of the sublet fee policy because it was included in the board-issued "shareholder handbook."

Condominium Fines

Condominium boards too must derive authority from their governing documents in order to impose enforceable fines or fees. In its 1998 decision in *Sweetman v. Bd. of Managers of Plymouth Village*,[6] the Supreme Court, Appellate Term, held that the condominium board had implied authority to adopt a rule imposing a fine for violating the bylaws' leasing provisions. The bylaws only gave the board the express right to terminate the lease and evict the improperly subleasing tenant. However, the court held that, by its terms, the eviction remedy in the bylaws was neither mandatory nor exclusive and the board was therefore permitted to adopt a fine—a less drastic remedy than eviction.

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However, courts have refused to imply authority where it is altogether lacking in the governing documents. For example, in 2006, in *Blumberg v. Albicocco*,[7] the condominium board imposed a $500 fine on a unit owner for creating a "nuisance and annoyance"—prohibited by the bylaws—by conducting a two-day garage sale at her premises. The Supreme Court, Nassau County, declined to find implied board authority to impose the fine because no bylaw specifically prohibited garage sales and no board resolution defined garage sales as a prohibited "nuisance."

As with co-op fines, courts stress adherence to governing documents and mandated procedures when analyzing whether board-sourced condominium fines will be upheld. In *Yusin v. Saddle Lakes Home Owners Assn.*,[8] the Second Department struck down a board-adopted rule and fine prohibiting homeowners from walking pets on the condominium's common areas. The court found that the condominium's bylaws "indicate" that homeowners are permitted to walk pets on the common areas and that in order to amend the bylaws, approval of 66 2/3 percent of the homeowners was required; approval from at least 51 percent of homeowners whose homes are subject to first mortgages was required to make a "material" change to the bylaws. The court held that the board's action was not authorized by the bylaws, based on "the evidence submitted,"—which presumably established that the board had not obtained approval from the requisite percentage of homeowners.

More recently, in 2015, in *Esposito v. Barr*,[9] in dicta, the Civil Court, Richmond County, explained that in order to uphold a condominium board's determination to levy a fine (for the alleged failure to timely certify cleaning of the owner's dryer vent) and penalty (suspending pool privileges for the failure to pay the disputed fines), the board must provide proof that it, in compliance with the declaration and bylaws, "passed resolutions requiring the certification of the cleaning of the dryer vent," "providing for a fine for the failure to do so, and a penalty in the event the unit owner failed to pay the fine"—none of which the board could prove.

With regard to condominium leasing fees, since publication of our 2013 column dealing with such fees, courts have yet to directly address their enforceability.[10] However, as discussed in our column and as held by the Second Department in the leading case of *Four Brothers Homes at Heartland Condominium II v. Gerbino*,[11] courts have upheld outright prohibitions on leasing in condominiums and would therefore likely sustain the imposition of leasing fees, if properly enacted and incorporated into the condominium's governing documents. In *Gerbino*, the unit owners argued that a blanket leasing prohibition unreasonably restrained their ability to alienate their apartments.

The court disagreed, noting that the Condominium Act authorized bylaws to contain such a provision and that the owners, "in choosing to purchase the home, willingly gave up certain rights and privileges which traditionally attend fee ownership of property." Based on this holding, we believe it is unlikely that a court would strike down a properly enacted leasing fee as an unreasonable restraint on alienation.

Standard of Review

Once a board demonstrates it has authority to impose a fine or a leasing fee, courts should apply the business judgment rule as the standard for review of an apartment owner challenge, as established by the Court of Appeals, which rule prohibits judicial inquiry into actions of corporate directors (including condominium board members) which are within their authority, and taken in good faith and in the exercise of honest judgment and the lawful and legitimate furtherance of corporate purposes.[12]

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However, where a board lacks sufficient authority, the court will not shield its actions from judicial inquiry. For example, where an authorizing provision permits a board to impose a "reasonable sublet fee" tied to the entity's expenses, a court will review the matter to ensure that the amount assessed does not contravene the authorizing provision. In *Bailey v. 800 Grand Concourse Owners*,[13] the First Department held that a sublet fee equal to 30 percent of the apartment's annual maintenance exceeded the fees permitted under the by-laws," which permitted the board to impose a "reasonable fee to cover [the co-op's] actual expenses and attorney fees."

Likewise, the First Department in *DeSoignies v. Cornasesk House Tenants' Corp.*[14] determined that a board-adopted house rule imposing a 10 percent surcharge on sublets was invalid because the authorizing provisions of the proprietary lease and bylaws allowed the board to impose a fee for "the proper fees of its attorneys and managing agent for services in connection" with the sublet; "there is no provision for a surcharge." Citing *Bailey*, the court invalidated the 10 percent subletting surcharge.

More recently, in 2011, in *Matter of Nielsen v. 35-21 79th St. Tenants Corp.*,[15] co-op apartment owners sought to enjoin enforcement of new sublet fees and restrictions adopted by the board. The Supreme Court, Queens County, applied the "sufficient authorization" test and held that the authorizing provisions of the co-op's lease and bylaws permitted the board to adopt the disputed sublet policy and denied injunctive relief. The authorizing provisions in *Nielson* expressly and unqualifiedly permitted the board to "subject any consent to sublet to such conditions as the directors may impose. There shall be no limitation."

Similarly, where board action deviates from the uniform treatment of shareholders and is not taken in good faith, such action will not be protected by the business judgment rule. In the 2015 decision in *Matter of Giaccio v. Brancati*,[16] the Supreme Court, Westchester County, held that the co-op board improperly terminated an owner's proprietary notwithstanding a lease provision permitting termination if an owner sublet an apartment without board consent.

The co-op's house rules provided that a $250 fine could be imposed for improper subletting, and an additional $50 fine for each day such subletting continued. Importantly, the record was replete with evidence of unequal shareholder treatment (only fines had previously been imposed for unapproved subletting—never had a lease been terminated—and even the fines had subsequently been waived), and personal animosity against the plaintiff owners. Thus, the business judgment rule did not protect the board's action in terminating the owners' lease, and the purported termination was vacated.

Unenforceable Penalties

New York's public policy prohibits enforcement of a penalty. Therefore, a court will review the amount of a fine or fee and may deny enforcement if it deems it to be a penalty.

For example, the Civil Court, Westchester County, in *Vernon Manor Co-op. Apartments v. Salantin*[17] held that a late charge equal to 100 percent of the payment in default was unenforceable "as confiscatory in character" because it did not represent a reasonable approximation of the cost or other loss "which might be incurred [by the co-op] by the default or in the process of collection."

More recently, in 2015, in *Board of Managers of the Park Ave. Ct. Condo. v. Sandler*,[18] the condominium bylaws authorized the board to set variable late fees "with no need to amend the bylaws." The board adopted a series of late fees which, had they been treated as "interest," would have equaled a rate of 60 percent a year. While the late fees were not characterized by the bylaws or the board as "interest" and although the bylaws provided for no limitation on the amount of such "late fees," the Supreme Court, New York County, held that the Penal Law,[19] which makes an interest charge of more than 25 percent a year a criminal offense, expressed a public policy which should be applicable to the challenged late fees and invalidated them.

Business Corporation Law

Co-op boards must ensure that the structure of fees/fines treats owners equally. Otherwise, they may be unenforceable for violating New York Business Corporation Law §501(c), which requires each share in a corporation to be "treated equal to every other share of the same class."[20] The failure to comply with Section 501(c) "is sufficient to overcome the protections afforded under the business judgment rule."[21]

For example, the First Department, in *Wapnick v. Seven Park Avenue Corp.*,[22] held that a sublet fee structure that favored original shareholders over subsequent purchasers was unlawful, even though it was provided for in the proprietary lease. Similarly, the First Department in *Bregman v. 111 Tenants Corp.*,[23] rejected an owner's claim that she had a "special" contractual right to sublet her apartments, unencumbered by co-op board approval and the payment of fees.

The court held that even if this "special" contract existed, it could not be enforced because doing so would violate Section 501(c), which precluded any such special subletting rights—the "statute rules out the proposition that a shareholder…may, by contract with the cooperative, obtain special rights that could not be granted in the corporate documents themselves."

More recently, in 2013, in *Razzano v. Woodstock Owners Corp.*,[24] the First Department unanimously reversed a lower court decision and declared invalid a sublet policy applicable to newer owners which was not equally imposed on owners of long standing, because it violated Section 501(c). The sublet policy allowed pre-2002 apartment purchasers to sublet their apartments, but prohibited those who purchased apartments after 2002 from doing so.

However, courts have consistently held that it is not a violation of Section 501(c) to exempt holders of unsold shares from sublet fees and board approval requirements applicable to other shareholders. In *Susser v. East 36th Owners Corp.*,[25] plaintiffs challenged such exemption, arguing that they violated Section 501(c); the relief sought was to obtain the exemption for all other shareholders.

The First Department found that the holder of unsold shares and all other shareholders were not similarly situated and that the special subleasing benefits accorded holders of unsold shares is recognized and approved in Section 501(c)'s legislative history. The First Department therefore rejected the challenge as against public policy because affording other shareholders the exemption would strip co-ops of their essential managerial prerogatives to restrict subleasing.

Condominiums

Because condominium associations are not incorporated entities, Section 501(c) does not apply to them. However, the Condominium Act provides for analogous proportionality and equal treatment requirements. Section 339-m of the Condominium Act[26] establishes the functional equivalent of a share-proportionate regime for condominiums. As such, we believe that like in co-ops, sublet policies in condominiums must apply equally to all unit owners.

Recommendations

First and foremost, before adopting and implementing fines for building rule violations or sublet or leasing fees, boards must ensure that they have the authority to do so under the entity's governing documents and adhere to the express language of the authorizing provision—including express restrictions on the board's authority such as "reasonable" or expense-based fees or fines.

Further, boards must treat all apartment owners equally, as required by Section 501(c) and analogous provisions and principles under the Condominium Act. Lastly, boards should exercise restraint in setting the amount or formula for the imposition of the fees/fines, so that they do not constitute an invalid and unenforceable "penalty." Certainly, no fee or fine should exceed 25 percent of the amount in default or be confiscatory. Following these guidelines should allow boards to feel comfortable and confident in establishing and imposing enforceable fines for rule violations and fees for subletting and l0easing.

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1. Richard Siegler and Eva Talel, "Enforcing House Rules—The Power to Fine." NYLJ May 5, 2004, pg. 3, col. 1; Richard Siegler and Eva Talel, "Board Authority to Impose Sublet and Leasing Fees." NYLJ Sept. 4, 2013, pg. 3, col. 1.
2. 147 Misc.2d. 1098 (Civ. Ct. City of Yonkers 1990).
3. 97 A.D.2d 736 (1st Dept. 1983).
4. NYLJ, March 15, 1994, p. 21, col. 3 (Sup. Ct. N.Y. Co.), aff'd as modified, 216 A.D.2d 45 (1st Dept. 1995).
5. 108 A.D.3d 697 (2d Dept. 2013).
6. 1998 WL 1112655 (Sup. Ct. App. Term 1998).
7. 12 Misc.3d 1045 (Sup. Ct. Nassau Co. 2006).
8. 73 A.D.3d 1168, 1169 (2d Dept. 2010).
9. 48 Misc.3d 1225(A) (Civ. Ct. Richmond Co. 2015). The court held that the jurisdictional limits of the civil court precluded the relief sought by the unit owner—essentially, a declaration that the fines were improperly assessed and the suspension of real privileges was improperly imposed. However, the court, in dicta, expressed its opinion that the challenged board actions would not be enforced if jurisdiction had been present.
10. See note 1, supra.
11. 262 A.D.2d 279 (2d Dept. 1999).
12. *Levandusky v. One Fifth Avenue Apartment Corp.*, 75 N.Y. 2d 530 (1990).
13. 199 A.D.2d 1 (1st Dept. 1993).
14. 21 A.D.3d 715, 717 (1st Dept. 2005).
15. 2011 WL 197731 Sup. Ct. Queens Co. 2011).
16. 2015 WL 2358316, (Sup. Ct. Westchester Co. 2015).
17. 15 Misc.2d 491 (Civ. Ct. Westchester Co. 1958).
18. 48 Misc.3d 1230(A) (Sup. Ct. N.Y. Co. 2015).
19. N.Y. Penal Code §190.42 (McKinney 2010).
20. N.Y. Bus Corp Law §501(c) (McKinney 2003); See, Richard Siegler and Eva Talel, "Constraints on Board Action—BCL § 501(c)." NYLJ March 5, 2008, pg. 3, col. 1, and *White v. Gilbert*, 2012 WL 3260300 (Sup. Ct. N.Y. Co. 2012).
21. Id.
22. 240 A.D.2d 245 (1st Dept. 1997).
23. 97 A.D.3d 75, 77 (1st Dept. 2012).
24. 111 A.D.3d 522 (1st Dept. 2013), reversing, 2012 WL 5280645 (Sup. Ct. N.Y. Co. 2012).
25. 262 AD2d 197 (1st Dept. 1999). See also, *Yatter v. Continental Corp.*, 22 AD3d 573 (2d Dept. 2005).
26. N.Y. Real Property Law, §339-m (McKinney 2006 & Supp. 2008).