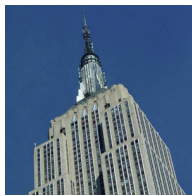


REAL ESTATE UPDATE

ATLANTIC YARDS—PUBLIC TAKING OR PRETEXT?



The Atlantic Yards Arena and Redevelopment Project in Brooklyn overcame a legal challenge on February 1, 2008, in the case of *Goldstein v. Pataki*, decided by the United States Second Circuit Court of Appeals. The plaintiffs-appellants, fifteen property owners whose homes and businesses are slated for condemnation to make way for the project, sought to block

its construction. They argued that the condemnation or “taking” of the private property of existing home and business owners to assemble the large swath of land required by the project violates the Fifth Amendment of the Constitution, which reads, in part, “Private property [shall not] be taken for public use, without just compensation.”

An expansive reading of the Fifth Amendment might lead one to conclude that as long as the owners of private property are justly compensated, their private property may be taken. This has never been the holding of the Supreme Court of the United States, however. The Supreme Court precedents all first require that the taking be for a “public purpose.” The definition of public purpose has, however, expanded more and more over the centuries. First, the entity to which the private property is given does not have to be a government or public entity; it can be another private individual who is going to put the property to a public use. Second, the public use does not have to be a use by the general public (such as a park or a school) – as long as the transferee’s project uses the property to serve a “public purpose,” the Fifth Amendment is not violated. Therefore, the Supreme Court has upheld legislative decisions to take property for public purposes as diverse as the building of railroads and the building of hotels. It has even done so to reduce the concentration of land ownership in the hands of a select few by taking property held in fee from landlords (and paying the landlords just compensation for it) and transferring those fee interests to tenants.

Fewer than three years ago, the Supreme Court affirmed in *Kelo v. City of New London* that “economic rejuvenation” and “promoting economic development” are public purposes for which the government can take private property from A and give it to B. The Supreme Court stated that determinations by a legislature of the needs of the local public—and whether such transfers of property will help address those needs—should be given great deference by courts, since making such judgments is

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precisely the role of the legislative branch of government. Legislatures spend much time considering proposals for addressing their districts' economic development concerns, and they, rather than courts, are therefore in the best position to determine the best solutions to those problems.

The checks and balances that the different branches of government have among them do leave room for judicial intervention in eminent domain cases. However, the Supreme Court states that the role of the courts is an extremely narrow one limited to ferreting out those takings of private property that are "palpably without reasonable foundation." In order for a court to overturn the legislature's determination that a project would serve a public good, the court would have to determine that there is no reasonable foundation for the legislature's determination that giving the property of A to B might achieve the public purpose that the legislature has defined.

In *Goldstein v. Pataki*, the appellate court found that the affected residents' argument was not that there was no reasonable foundation for the legislature's findings that the Atlantic Yards project will benefit the area, but that the project's costs will outweigh its public uses, "among them the redress of blight, the creation of affordable housing, the creation of open space, and various mass-transit improvements." Reiterating the limited role of the judiciary in policing the legislature's determinations, the appellate court concluded that "the Atlantic Yards Project may not be successful in achieving its intended goals. But whether in fact the Project will accomplish its objectives is not the question: the constitutional requirement is satisfied if the state rationally could have believed that the taking would promote its objective."

The affected residents also argued that *Kelo* requires that takings pass an additional test in order to be constitutional – even if a taking is determined to be rationally related to a public use, the courts must make an inquiry into whether the public uses produced by the taking are only a "pretext" for an actual illicit purpose of bestowing a private benefit to the particular developer of the project. The appellate court found that trying to determine whether there is such an illicit pretext for the taking would "add an unprecedented level of intrusion into the process," and that "it is only the taking's purpose, and not its mechanics that must pass [judicial] scrutiny."

The legal battle over the Atlantic Yards has not ended, however. In late March eleven of the property owners and tenants in the affected neighborhood filed a petition appealing to the Supreme Court. The petition seeks to probe the "pretext" argument further, alleging that the developer is abusing eminent domain for a project that will be more beneficial to its chief executive than the local community. Stay tuned to see if the Supreme Court agrees to hear the case.

YOU SCRATCH MY BACK, AND I'LL SCRATCH YOURS

Can tenants occupying a rent-stabilized apartment as their non-primary residence agree to pay rent higher than the legally prescribed rent for such apartment in return for which their landlord would agree not to pursue an eviction action on the grounds that the apartment is not the tenants' primary residence?

On February 7, 2008, the New York Court of Appeals decided the case of *Riverside Syndicate, Inc. v. Munroe et al.* A couple had subleased a rent-stabilized apartment on the Upper West Side of Manhattan. After the landlord, claiming that the sublease was illegal, sued to evict them, the case was settled in 1996 according to a court-approved stipulation between the landlord and the couple that covered one apartment created by the combination of the contested apartment with two other rent-stabilized apartments, with the couple now as the direct tenants of the combined apartment.

According to the court, the stipulation recognized the tenants as the lawful, rent-stabilized legal tenants of the consolidated apartment at a monthly rate of \$2,000, a rent far in excess of the maximum rent allowed by the rent stabilization laws. The agreement also stated that the tenants waived all right to challenge the legality of the rent but that, regardless of their primary residence, the couple could remain as the rent-stabilized tenants. Lastly, the agreement also provided for rent in the case the apartments were deregulated, at which time the landlord would offer a renewal lease to the tenants every two years, at a rent increase of no more than eight percent.

All parties complied with the stipulation, including between 2000 and 2003, a period during which the apartments were deregulated. In 2004 the landlord brought an action seeking a declaratory judgment that the 1996 agreement violated public policy and was void.

Examining the Rent Stabilization Law (RSL) and the regulations promulgated pursuant to the RSL, the Rent Stabilization Code, the court held unanimously that the stipulation was void and unenforceable. To the court, the legal argument was clear-cut. The Code states that the only benefit of the RSL or the Code that a tenant may waive is the benefit of a complaint the tenant may have pending before the New York State Division of Housing and Community Renewal (DHCR). In other words, a tenant may, under certain circumstances, withdraw a complaint pending before the DHCR, effectively waiving the benefit of pursuing the complaint provided by the rent stabilization laws. By agreeing to pay more than the prescribed stabilized rent, the tenants in this case waived a benefit of rent stabilization that the Code does not permit to be waived, and such a waiver is void.

But can't a tenant manipulate the Code to get around this prohibition by bringing a complaint regarding the excess rent before the DHCR and then properly withdrawing his complaint? Wouldn't this be a legitimate waiver of the benefits of a complaint, which would, in effect, be a legitimate waiver of his right not to pay rent above the rent-stabilized rent?

To answer this question and to reach its ultimate decision, the court also examined the landlord's end of the bargain. As consideration for the tenants' waiver of their rights, the agreement provided for the landlord's waiver of his rights under the Code to recover possession of an apartment not occupied by a tenant as his or her primary residence. While a waiver of this right by the landlord is not prohibited by statute, the court found that its precedents prohibited such a waiver because it allows tenants who can afford two rent-stabilized apartments to use the law for purposes contrary to those for which it was written, i.e., to increase the availability of housing on the open market. Whether they do it outright or through manipulation of the Code, tenants cannot waive their rights to rent stabilization if the benefit the landlord gives them in return is one that frustrates the public policy behind the rent-stabilization laws.

Are there any situations in which tenants may pay rent higher than the rent-stabilized amount in return for a favor from the landlord without improperly waiving their rights under the Code? Yes, as long as the consideration that the tenants receive for the higher payment does not violate public policy—for example, tenants who pay higher rent in return for having their apartment painted more frequently than required by the rent-stabilization laws. It is not contrary to public policy to have a well-painted rent-stabilized apartment.

But what about the arrangements contained in the agreement at hand for the collection of rent *after* deregulation? Don't the parties remain bound by this part of the agreement in which neither waived any rights under the rent-stabilization laws? No, the court concluded that the entire stipulation is void. The landlord is, therefore, no longer bound by the eight-percent biennial rent increases contained in the agreement.

The ruling was not a one-sided victory for the landlord, however. The court suggested that the tenants may have a strong claim to recover the excess rent that they paid while the apartment was rent-stabilized and that they may also have a strong claim to rescind the deregulation of the apartments, if the deregulation was the result of the illegal agreement.

To summarize, the lessons to be learned here are—

1. Tenants cannot voluntarily pay more rent for a rent-stabilized apartment if the consideration they receive in return from the landlord violates public policy.
2. A landlord cannot, in exchange for increased rent, voluntarily waive the requirement that a rent-stabilized apartment be a tenant's primary residence.
3. A court will find such an agreement, and not only its unlawful parts, entirely unenforceable.
4. If such an agreement is found unenforceable, a tenant may have the right to recover any amounts paid over the rent-stabilized amount, despite having received a benefit for overpaying.

LLC DERIVATIVE SUITS—NEW YORK COURT OF APPEALS MOVES THE LAW CLOSER TO DELAWARE

If the members of a limited liability company (LLC) formed in New York believe that the managers of the LLC have injured the LLC, can they bring a suit against the managers? Although a line of rulings has found that members can bring direct claims against the managers of an LLC whereby they allege that they as members have been injured by the actions of the managers, the various New York lower courts have been split on the issue of derivative suits, in which the members of the LLC bring the claims not on behalf of themselves, but on behalf of the LLC itself. The damages in a successful derivative suit would be awarded to the LLC and not to the individual members.

Derivative suits are not a new concept, but the most common scenario is in the context of corporations. The rights of corporate shareholders to sue the fiduciaries of a corporation have long been written into the statutes of many states, including those of New York. New York's statutes also give limited partners the right to sue derivatively. However, when New York first legalized LLCs in 1994 with the passage of the Limited Liability Company Law (the "New York Act"), the legislature did not include any provisions addressing derivative suits. In contrast, the Delaware Limited Liability Act permits a member of a Delaware limited liability company to bring derivative lawsuits, and their rights to do so cannot be written away in the limited liability company agreement.

In *Tzolis v. Wolff*, the New York Court of Appeals found that the silence of the New York Act on the issue of derivative suits does not imply that the New York Act bans LLC derivative suits. The minority disagreed, pointing to the fact that there is no Article IX in the New York Act, because what was to be Article IX was a provision expressly authorizing derivative suits that was intentionally omitted. In the court's majority view, since English and American courts permitted derivative suits before statutes were passed to codify the governing of corporations, partnerships and LLCs, if a statute does not expressly eliminate a right that existed before the statute was passed, the court-created right, the common-law right, remains. The majority wrote, "For us, the most

salient feature of the legislative history [of the passage of the New York Act] is that no one, in or out of the Legislature, ever expressed a wish to eliminate, rather than limit or reform, derivative suits.”

What does this decision mean for members and fiduciaries of New York LLCs? This newly affirmed right of members of an LLC to sue on behalf of the LLC for damages allegedly done to the LLC by its fiduciaries is not codified. Further, the court did not lay out any parameters for what would constitute a legitimate suit, provide any procedure for bringing such lawsuits, or address whether the right to bring a derivative suit could be waived in the LLCs operating agreement. Consequently, the decision leaves open many issues. The majority pointed to the state law’s limitations on corporate derivative suits as a source of guidance for LLC derivative suits. Some predict a proliferation of LLC derivative suits, in which case the courts will be forced to answer these questions as they are presented, thereby creating a body of common law governing these suits, or the legislature will need to step in and insert the long-missing Article IX either expressly banning such suits or setting out their parameters and procedures.

CONTACT INFORMATION

If you have questions, please contact one of the lawyers listed below:

Practice Manager

Peter A. Miller 212.872.1004 pamiller@akingump.com New York

Managing Editor

Jordan J. Metzger 212.872.8057 jmetzger@akingump.com New York

Contributing Editor

Didier P. Jean-Baptiste 212.872.8055 djeanbaptiste@akingump.com New York

Real Estate and Finance Partners

Robert W. Dockery 214.969.4316 rdockery@akingump.com Dallas

Michael C. Elrod 210.281.7231 melrod@akingump.com San Antonio

Joseph Ginsberg 212.872.1031 jginsberg@akingump.com New York

Carl B. Lee 214.969.2726 clee@akingump.com Dallas

Michael S. Mandel 202.887.4196 mmandel@akingump.com Washington, D.C.

R. Terry Miller 214.969.4237 tmiller@akingump.com Dallas

Peter J. Mort 310.229.1007 pmort@akingump.com Los Angeles

Randall M. Ratner 214.969.2893 rratner@akingump.com Dallas

Anthony R. Salandra 310.229.1018 tsalandra@akingump.com Los Angeles

Hushmand Sohaili 310.229.1060 hsohaili@akingump.com Los Angeles

Michael W. Wood 713.220.8111 mwood@akingump.com Houston

Austin	Beijing	Dallas	Houston	London	Los Angeles	Moscow
New York	Philadelphia	San Antonio	San Francisco	Silicon Valley	Taipei	Washington, D.C.