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## The New Residential Tenancy Law—Are Landlords Public Utilities?

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By Lawrence Berger\*

# The New Residential Tenancy Law—Are Landlords Public Utilities?

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## I. INTRODUCTION

It is clear that during the last twenty years there has been a tremendous revolution in landlord-tenant law, particularly with respect to residential property. If the old law, as it was argued,<sup>1</sup> was biased in favor of the landlord, then the new law is perhaps just as patently so in favor of the tenant. In fact, it has been said that the law as it now stands tends to regulate residential landlords much as it does public utilities.<sup>2</sup> This sea-change in the rules toward tenant protection has met with the overwhelming critical acclaim of the commentators.<sup>3</sup> Whether as a matter of policy the new pro-tenant rules make any more sense than the old pro-landlord rules is the subject of this article. I will first briefly sketch both the old and the new rules. I will then compare the new rules with public

1. See, e.g., J. CRIBBET, *PRINCIPLES OF THE LAW OF PROPERTY* 198 (2d ed. 1975).

2. In *Robinson v. Diamond Housing Corp.*, 463 F.2d 853 (D.C. Cir. 1972), Judge Robb dissented to the majority view that a landlord seeking to evict his tenant for nonpayment of rent must show that he is financially unable to make repairs, or show other substantial business reasons for taking the property off the market where the tenant is claiming that the eviction is retaliatory. He said:

The theory of the majority seems to be that if not an outlaw a landlord is at least a public utility, subject to regulation by the court in conformity with its concept of public convenience and necessity. I reject that notion, which in practical application will commit to the discretion of a jury the management of a landlord's business and property.

*Id.* at 871. See also C. Berger, *A Public Utility View of Rental Housing*, 50 PA. B.A.Q. 234 (1979).

3. See, e.g., Daniel, *Judicial and Legislative Remedies for Substandard Housing: Landlord-Tenant Law Reform in the District of Columbia*, 59 GEO. L.J. 909, 930-43 (1971); Moskovitz, *Rent Withholding and the Implied Warranty of Habitability*, 4 CLEARINGHOUSE REV. 49, 63-66 (1970); Note, *Judicial Expansion of Tenants' Private Law Rights: Implied Warranties of Habitability and Safety in Residential Urban Leases*, 56 CORNELL L. REV. 489, 495-501 (1971); Note, *Landlord's Violation of Housing Code During Lease Term is Breach of Implied Warranty of Habitability Constituting Partial or Total Defense to an Eviction Action Based on Nonpayment of Rent*, 84 HARV. L. REV. 729 (1971).

utility doctrine and examine whether they accord with notions of fairness and efficiency.

## II. THE OLD LAW

### A. The Doctrine of Independent Covenants Generally

Much of the common law of landlord-tenant can be traced to an old dogma—that a lease of realty was deemed predominantly a conveyance of an interest in *land* rather than a contractual arrangement between two parties, and that therefore the general law of contracts did not apply. In contract law, the doctrine of independent covenants had been repudiated by Lord Mansfield in *Kingston v. Preston*<sup>4</sup> in 1773. But it took almost an additional 200 years for landlord-tenant law to begin to reach a similar conclusion. The doctrine of independent covenants was that the failure to perform a promise by one party did not excuse performance of the counter promise by the other party, unless the contract specifically so provided. Thus, if an employer contracted to hire an employee for one year at a certain salary, the employee could recover the salary even though he never did a day's work.<sup>5</sup> Of course, the employee would also be liable in damages for his own failure to perform. What Lord Mansfield did was to say that such promises should be dependent. In the case stated above, that would mean that the employer should not be liable for the agreed salary unless the employee performed his end of the bargain.

As noted, landlord-tenant law did not follow general contract principles with respect to this question. The reason given was that a lease was regarded as a transfer of an interest in land rather than as a contract containing mutual promises, and therefore the new contract doctrine of dependence did not apply. The fact that lease covenants continued to be deemed independent had a substantial effect on the practical affairs of landlords and tenants. It is probably fair to say that overall, though with some major exceptions, application of the rule tended to favor the landlords. Let us examine briefly the various effects.

First, breach by the landlord of an obligation expressly imposed upon him by the lease did not excuse the tenant from paying rent. For example, if the landlord breached his covenant to repair,<sup>6</sup> or to pay taxes on the premises,<sup>7</sup> or even to rebuild them if destroyed,<sup>8</sup>

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4. This case was noted in *Jones v. Barkley*, 99 Eng. Rep. 437-38 (K.B. 1781).

5. Anonymous, Y.B. Pasch. 15 Hen. 7, f. 10b, pl. 7 (1500), noted in J. MURRAY, *CONTRACTS* § 155, at 302 (2d rev. ed. 1974).

6. *Stone v. Sullivan*, 300 Mass. 450, 15 N.E.2d 476 (1938); *Stewart v. Childs Co.*, 86 N.J.L. 648, 92 A. 392 (1914).

7. *Barry v. Frankini*, 287 Mass. 196, 191 N.E. 651 (1934).

8. *Tyson v. Weil*, 169 Ala. 558, 53 So. 912 (1910).

the tenant's rent liability continued. In such case, of course, the tenant had a right to recover damages for the landlord's breach even though the tenant was himself in arrears on the rent.<sup>9</sup>

Second, as a general proposition, failure of the tenant to pay the rent,<sup>10</sup> or his breach of other covenants,<sup>11</sup> did not excuse the landlord's liability to perform. That is, the landlord would still have an obligation not to disturb the tenant's possession and as a matter of law could not evict the tenant for the breach.

Thus, on its face, the doctrine of independent covenants operated symmetrically: breach by either party did not excuse counterperformance by the other. But by necessity, the doctrine soon was eroded in favor of landlords in some cases and tenants in others, and it can be argued that as a result of these changes the symmetry was more apparent than real. In favor of the landlord there were two operating factors. First, since the rule of independent covenants operated only where the lease was silent on the subject, and since leases were ordinarily drafted by or for landlords, it became customary to provide that breach by the tenant of his lease obligations would be grounds for termination at the landlord's option. Second, statutes were passed in virtually every state that provided for a summary procedure to evict a tenant who failed to pay the rent as due.<sup>12</sup> Thus, landlords were protected from the harsh application of the old rules. Many tenants, on the other hand, did not know or have enough bargaining power to provide similar protection for themselves by way of lease provisions. Moreover, there were no statutes providing that breach of a substantial obligation by the landlord excused tenants from performance.<sup>13</sup>

Nevertheless, it would be unfair to say that the common law system was completely biased against the tenant, for the courts early developed the theories of actual and constructive eviction which, though not stated as such, were really substantial limitations upon the independent covenants doctrine. Under the law as it evolved, the courts held that in every leasing there was an im-

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9. 3A A. CORBIN, CONTRACTS § 686, at 269 n.60 (1960) and cases therein cited.

10. *Myles v. Strange*, 226 Ala. 49, 145 So. 313 (1932); *Standard Live Stock Co. v. Pentz*, 204 Cal. 618, 269 P. 645 (1928).

11. *In re Pennewell*, 119 F. 139 (6th Cir. 1902) (tenant breached covenant against sublease).

12. The statutes are collected in 6 S. WILLISTON, CONTRACTS § 890B (3d ed. Jaeger 1962).

13. Though there were statutes providing that destruction of the leased premises would be ground for termination of the lease. See 7 S. WILLISTON, CONTRACTS § 944A (3d ed. Jaeger 1962).

plied covenant of quiet enjoyment,<sup>14</sup> *i.e.*, an engagement that the tenant's possession would not be disturbed by the landlord, those claiming under him, or those claiming a title superior to his. As an example, if the landlord physically invaded the premises forcing the tenant to leave, this was a breach of implied covenant of quiet enjoyment and constituted an actual eviction which would be a defense to any action by the landlord for rent accruing after the wrongful act.<sup>15</sup>

It was the extension of this notion to less flagrant landlord behavior which the courts characterized as a "constructive" eviction that is of particular interest here. For there developed the notion that "where, although there has been no physical expulsion or exclusion of the tenant, the landlord's wrongful acts substantially and materially deprive the tenant of the beneficial use and enjoyment of the premises"<sup>16</sup> and the tenant as a result abandoned possession, this would be deemed a constructive eviction which would be a defense to an action for rents accruing after the tenant left. The real catch in the rule lay in the ambiguity of what constituted those wrongful acts of a landlord which would justify a tenant's abandonment of the premises. The lay person might, for example, think that if a landlord were to allow residential premises to fall into such disrepair as to become uninhabitable, this would be a sufficient wrongful act. But that was not the law. The courts held early that there was no implied warranty that the premises were fit for the purposes let; therefore, the landlord generally had no obligation with respect to habitability.<sup>17</sup> Of course if he committed affirmative acts destructive of habitability (deliberately releasing vermin on the premises?), that would be sufficient; but needless to say, such was an unusual case. The doctrine of constructive eviction as applied to passive behavior was limited, then, to situations where the landlord was said to have a "duty" with respect to the condition of the premises. Such a duty could be imposed by an express clause in the lease, or by statute<sup>18</sup> or ordinance.<sup>19</sup> In their

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14. 1 AMERICAN LAW OF PROPERTY § 3.47, at 272 nn.3 & 4 (A. Casner ed. 1952). Some states required that the technical words "demise" or "grant" be used. *Id.*

15. *Id.* § 3.50.

16. *Barash v. Pennsylvania Terminal Real Estate Corp.*, 26 N.Y.2d 77, 83, 256 N.E.2d 707, 710, 308 N.Y.S.2d 649, 653 (1970). *Dyett v. Pendleton*, 8 Cow. 727 (N.Y. 1826), was probably the first American case that recognized this doctrine.

17. 1 AMERICAN LAW OF PROPERTY, *supra* note 14, § 3.45.

18. In a number of states, legislation provided that the residential landlord had an obligation to provide fit premises. CAL. CIV. CODE § 1941 (West 1954) (first passed in 1872); 41 OKLA. STAT. ANN. tit. 41, § 31 (West 1951 & Supp. 1980) (first passed in 1890 and repealed in 1978); S.D. COMP. LAWS ANN. § 43-32-8 (1967) (first passed in 1877).

19. For a brief history of tenement house ordinances and their enforcement in

absence, constructive eviction did not apply and therefore, as a practical matter, residential tenants often lacked protection against uninhabitable premises.

### B. Destruction of Leased Premises

It was well established at common law that destruction of the leased premises did not discharge the tenant's liability to pay the rent.<sup>20</sup> Two reasons were traditionally given. First, it was said that the lease was predominantly a conveyance of an estate in land; the use of the building was incidental.<sup>21</sup> Reasoning from this theory, the courts in the United States did not apply the general rule where the lease was of a part of a building or of a building without the land.<sup>22</sup> A second reason was the traditional independent covenants bugaboo that underlay much of landlord-tenant law.<sup>23</sup>

The old approach seems terribly unjust today. It appears clear to me that most leases involve a contract where the desire for sheltered space is the dominant motive and that destruction of the building ought to discharge the tenant's obligation on the theory of impossibility. Nevertheless, both Professors Williston<sup>24</sup> and Corbin<sup>25</sup> seem to have defended the old rule. On this issue, the state legislatures were ahead of the professors, for in most states statutes were passed giving tenants the option of vacating and terminating their rental obligation.<sup>26</sup> It was the legislatures, then, rather than the courts that took the lead in reforming the law along lines more in consonance with modern needs.

### C. The Duty to Repair and Rebuild

In the absence of a covenant or statute binding him to do so, the landlord was under no obligation to the tenant to keep the leased

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New York City, see Gribetz & Grad, *Housing Code Enforcement: Sanctions and Remedies*, 66 COLUM. L. REV. 1254, 1259-81 (1966).

20. *Buerger v. Boyd*, 25 Ark. 441 (1869); *Cowell v. Lumley*, 39 Cal. 151 (1870); *White v. Molyneux*, 2 Ga. 124 (1847); *Harris v. Heackman*, 62 Iowa 411, 17 N.W. 592 (1883); *Roberts v. Lynn Ice Co.*, 187 Mass. 402, 73 N.E. 523 (1905); *Bowen v. Clemens*, 161 Mich. 493, 126 N.W. 639 (1910); *Nashville, C. & St. L. Ry. v. Heikens*, 112 Tenn. 378, 79 S.W. 1038 (1904).

Nebraska was one of the few states refusing to follow the common law rule. *Wattles v. South Omaha Ice & Coal Co.*, 50 Neb. 251, 69 N.W. 785 (1897).

21. 1 AMERICAN LAW OF PROPERTY, *supra* note 14, § 3.103, at 397 n.4.  
 22. *Alexander v. Dorsey*, 12 Ga. 12 (1852); *Womack v. McQuarry*, 28 Ind. 103 (1867); *Shawmut Nat'l Bank v. Boston*, 118 Mass. 125 (1875); *Graves v. Berdan*, 26 N.Y. 498 (1863).  
 23. 6 S. WILLISTON, *supra* note 12, § 890, at 589 n.5.  
 24. *Id.* § 946.  
 25. 6 A. CORBIN, CONTRACTS § 1356 (1962).  
 26. For a tabulation of the statutes see 6 S. WILLISTON, *supra* note 12, § 944A.

premises in repair.<sup>27</sup> The rule was the same whether the premises were totally destroyed or just needed minor repairs. If repairs were to be done by the landlord at all, they were done without the compulsion of law. That is not to say that very substantial repair obligations were imposed upon the tenant either. His obligation was merely to refrain from committing permissive waste; that is, to make those *minor* repairs necessary to keep the premises wind and water tight or from deteriorating.<sup>28</sup> Thus, the tenant was obligated to fix a broken window or replace a missing shingle but not to replace an entire roof blown off by the elements. The law left to market forces the decision of whether the last mentioned repair would be made, and if so, by whom. One would surmise, for example, that the landlord as a practical matter would replace the roof where the lease was a short-term residential one, but the tenant would, where it was a long-term commercial net arrangement. The hands-off approach of the law naturally prompted landlords and tenants to make their own agreements with respect to the repair issue. It became customary, therefore, to include a covenant concerning the duty to repair in most leases.

Where the lease imposed a general duty to repair on the tenant, most courts held that this obligated him to completely rebuild the premises in the event of their destruction.<sup>29</sup> Some courts reached the opposite result on the theory that "repair" contemplated the existence of a structure upon which to work.<sup>30</sup> In some states, the legislature reversed the severe common law rule by statute.<sup>31</sup>

#### D. The Duty to Deliver Possession

Although it was clear that a landlord was liable to his tenant for damages for his failure to himself vacate the premises in time for his tenant to take possession at the beginning of the lease,<sup>32</sup> there has been a split of authority as to whether he was so liable if the tenant was prevented from entering by the wrongful act of a prior holdover tenant. Under the so-called American rule, the landlord had only the obligation to give the tenant a valid right to possess,<sup>33</sup>

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27. 1 AMERICAN LAW OF PROPERTY, *supra* note 14, § 3.78, at 346 n.1.

28. *Id.* at 347 nn.4 & 5.

29. *Fowler & Moore v. Payne*, 49 Miss. 32 (1873); *Chambers v. North River Line*, 179 N.C. 199, 102 S.E. 198 (1920); *McKinley v. C. Jutte & Co.*, 230 Pa. 122, 79 A. 244 (1911); *Priest v. Foster*, 69 Vt. 417, 38 A. 78 (1897).

30. *Realty & Rebuilding Co. v. Rea*, 184 Cal. 565, 194 P. 1024 (1920); *Orient Ins. Co. v. Pioneer Mill Co.*, 27 Hawaii 698 (1924); *Wattles v. South Omaha Ice & Coal Co.*, 50 Neb. 251, 69 N.W. 785 (1897).

31. *See, e.g.*, 2A N.C. GEN. STAT. § 42-9 (1976).

32. *Adair v. Bogle*, 20 Iowa 238 (1866).

33. *Field v. Herrick*, 101 Ill. 110 (1881); *Pendergast v. Young*, 21 N.H. 234 (1850); *Edwards v. McLean*, 122 N.Y. 302, 25 N.E. 483 (1890); *Teitelbaum v. Direct Re-*



under the English rule, the landlord was liable if by the wrongful act of a prior holdover tenant, the tenant could not actually enter.<sup>34</sup> The argument for the American approach was that a person should not be vicariously liable for the wrongful acts of a third person. To many, an approach leaving the new tenant with the obligation to clear the premises of a prior holdover tenant seems most unjust; the Uniform Residential Landlord and Tenant Act reverses this rule.<sup>35</sup>

### E. Tenants' Abandonment and the "Duty to Mitigate"

In the law of contracts generally, where there has been a breach, the injured promisee cannot recover those damages which he could have avoided by the exercise of reasonable diligence.<sup>36</sup> Thus, a wrongfully discharged employee may not recover for lost wages if he could have secured other comparable employment; his damages are reduced by the amount which he could have earned.<sup>37</sup> These rules historically did not apply to landlord-tenant law. When a tenant wrongfully abandoned leased premises, the landlord was free to allow the premises to lie idle and collect the full rent from the tenant.<sup>38</sup> He had no "duty to mitigate." To handle the problems of tenant liability the courts instead developed the doctrine of acceptance of surrender. Under that approach, when the tenant abandoned the premises his liability for rent continued unless the landlord was deemed to have accepted the tenant's surrender. This would occur upon the landlord's reentry and reletting of the premises. In some states, the landlord could forestall the discharge of rent liability by sending notice to the tenant of (1) the reletting, and (2) the landlord's intention to hold the tenant liable for the balance.<sup>39</sup> In New York, the reletting was deemed an acceptance of surrender unless the tenant consented to the reletting.<sup>40</sup> In other states, the reletting created a question of fact as to the landlord's intention to accept surrender.<sup>41</sup>

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alty Co., 172 Misc. 48, 13 N.Y.S.2d 886 (Sup. Ct. 1939); *Hannan v. Dusch*, 154 Va. 356, 153 S.E. 824 (1930).

34. *Cheshire v. Thurston*, 70 Ariz. 299, 219 P.2d 1043 (1950); *Dilly v. Paynsville Land Co.*, 173 Iowa 536, 155 N.W. 971 (1916); *Wallace v. Carter*, 133 Kan. 303, 299 P. 966 (1931); *Herpolsheimer v. Christopher*, 76 Neb. 352, 111 N.W. 359 (1907); *Adrian v. Rabinowitz*, 116 N.J.L. 586, 186 A. 29 (1936); *Oriental Oil Co. v. Lindsey*, 33 S.W.2d 768 (Tex. Civ. App. 1930).

35. UNIFORM RESIDENTIAL LANDLORD AND TENANT ACT § 2.103.

36. *J. MURRAY*, *supra* note 5, § 227.

37. *Hollwedel v. Duffy-Mott Co.*, 263 N.Y. 95, 188 N.E. 266 (1933).

38. 1 AMERICAN LAW OF PROPERTY, *supra* note 14, § 3.99, at 392 n.16, and cases therein cited.

39. *Id.* at 393 n.18.

40. *Id.* at 393 n.20.

41. *Id.* at 393 n.19.

In recent years, the courts have tended to discard these old rules and have adopted the general contract rule imposing a duty to mitigate upon the landlord.<sup>42</sup> The Uniform Residential Landlord and Tenant Act has adopted a similar rule.<sup>43</sup>

#### F. Summary

What does this review of the old rules show about the so-called bias of the law for landlords? Perhaps it can be summed up this way. The purportedly neutral common law doctrines of landlord-tenant probably in operation leaned more heavily against the tenant than against the landlord. Nevertheless, by the beginning of the twentieth century, the courts and legislatures had ameliorated much of the harshness. The doctrine of constructive eviction had diluted the most adverse effects of covenant independence, particularly with respect to residential properties where statutory or municipal obligations of housing fitness had been introduced. Statutory reform had changed the old rule that destruction of leased premises did not discharge the obligation to pay rent, as well as the doctrine that the tenant's general covenant to repair included the obligation to rebuild. Courts in a number of states had discarded the old rules on acceptance of surrender and replaced them with the contract notion of mitigation of damages.

However, in the past fifteen to twenty years what has happened to landlord-tenant law goes much beyond simple reform of the old rules. It can be fairly said that a revolution of rather major proportions has occurred. I will next examine the outlines and policy implications of the new rules.

### III. THE NEW LAW

#### A. Introductory Comments

The most important recent developments in landlord-tenant rules have been in three major areas: (1) rent and eviction control; (2) anti-condominium conversion legislation; and (3) warranty of habitability rules. Some have argued with approval,<sup>44</sup> others with alarm,<sup>45</sup> that the result of these developments is that the landlord is beginning to be treated more and more like a public utility and less and less like an ordinary business person. Whether this is true, and if so, whether it is a salutary trend will be examined here by comparing the above developments with their

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42. See, e.g., *Bernstein v. Seglin*, 184 Neb. 673, 171 N.W.2d 247 (1969).

43. UNIFORM RESIDENTIAL LANDLORD AND TENANT ACT § 4.203(c).

44. C. Berger, *supra* note 2.

45. *Robinson v. Diamond Housing Corp.*, 463 F.2d 853, 871 (D.C. Cir. 1972) (Robb, J., dissenting).

public utility counterparts as well as their respective justifications. Each development will then be examined to determine whether it meets criteria of fundamental fairness and economic efficiency.

## B. Price Regulation Versus Rent Control

### 1. *The Background*

The prices charged and the profits realized by a public utility are closely regulated by an administrative agency.<sup>46</sup> Regulation of electric, gas, railroad, truck and air rates among others has been a familiar part of the American scene for a very long time. The historic justification for the imposition of price control on a public utility was its natural monopoly position. Without such regulation it would be in a position to charge a price set to maximize its profits. That price would be higher than one where competition existed. The economic argument against this state of affairs was that where the higher price was charged, too few of the monopolized item, and more than an optimum of other items would be produced, leading to a lower than optimum total production. Regulation only makes sense, however, where the utility is in a natural monopoly industry, that is, where "one firm can supply the entire output demanded at a lower cost than could more than one firm."<sup>47</sup> Otherwise, it would be better to allow entry into the market and let the price be set by competition.

It is ironic that while deregulation of some of the historically regulated areas is being seriously discussed or commenced because of the perceived inefficiency of price regulation in situations where competition could better set the price, rent control is at the same time being advocated or imposed as the "solution" to the housing problem in this country. Nevertheless, at the present time, the trend toward rent control in many places in the United States is very strong. A short review of the history of this form of regulation will provide a useful background.

Rent control is and has been a very widely used device throughout the world. One author listed over 100 countries where rent control legislation had been adopted.<sup>48</sup> If nothing else, this shows how widespread is the notion that economic forces can be controlled and contained by governmental fiat.

Although there is probably no credible evidence of the exist-

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46. See 1 A. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 20-63 (1970). The discussion of public utility regulation in the text is derived from this source.

47. R. POSNER, *ECONOMIC ANALYSIS OF LAW* 252 (2d ed. 1977).

48. Willis, *A Short History of Rent Control Laws*, 36 *CORNELL L.Q.* 54, 93-94 (1950). The historical discussion of rent control in the text is derived from this source.

ence of rent control in ancient times, there is a vast amount of data dating its existence at least back to the Jewish ghetto of sixteenth century Rome. The Jews were forced to live in a walled area, and since the number of dwellings therein was limited, the rents tended to be much higher than in the rest of the city.<sup>49</sup> Papal rent control was imposed. Medieval France and Spain also had rent control regulation.

In the twentieth century, the major impetus for the widespread enactment of rent control legislation has been war and the housing shortages often accompanying war's destruction and lack of construction. In the United States, the first such statutes were passed after World War I in the District of Columbia<sup>50</sup> and New York.<sup>51</sup> They expired in 1925 and 1928 respectively.

With the advent of World War II, Congress passed the Emergency Price Control Act of 1942.<sup>52</sup> Under it, residential rent control was imposed by federal regulation in most cities with populations over 50,000. There was no similar control over commercial rents. Limited federal rent control continued until 1954.

New York City has had some form of rent control continuously since 1943.<sup>53</sup> When the federal controls expired, the New York State Legislature continued them until 1962 when the city was given authority to maintain them. The city originally applied its control program only to housing built before 1947. In 1969, however, it extended a new rent "stabilization" program to units built between 1947 and 1969. Under this program, a board allowed certain increases per year for leases expiring during that year. In 1970, the control system was changed to establish a maximum base rent designed to allow for proper maintenance and operation of the housing unit. Rents were allowed to increase seven and one-half percent per year to reach the base rent figure. Rent control and stabilization laws continue in New York City to this day.

The 1970's ushered in the tremendous growth of rent control laws across the United States and the federal government pro-

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49. The discrimination in housing faced by blacks and other minorities forced to live within modern ghettos accounts for the higher rents that they universally pay. Limited supply combined with strong demand will inexorably lead to higher prices.

50. Flood Control and the District of Columbia Rents Act, ch. 80, §§ 101-122, 41 Stat. 297 (1919). This act was extended and amended in 1922 and 1924, and expired in 1925.

51. Act of Sept. 27, 1920, chs. 942-945, 947, 951, 1920 N.Y. Laws 2477-88. This Act was extended and amended in 1922, 1924 and 1926, and expired in 1928.

52. Emergency Price Control Act of 1942, ch. 26, § 2, 56 Stat. 23 (repealed 1966).

53. The history contained in the text is outlined briefly in Baar, *Rent Control in the 1970's: The Case of the New Jersey Tenants' Movement*, 28 HASTINGS L.J. 631, 634-36 (1977), and Utt, *Rent Control: History's Unlearned Lesson*, 8 REAL EST. REV. 87, 89 (1978).

vided the impetus. On August 15, 1971, President Nixon ordered a ninety day freeze on wages and prices, including rents, under powers granted him by the Economic Stabilization Act of 1970.<sup>54</sup> Phase II of the control program replaced the original freeze, and provided for some flexibility in rent increases under a complex set of regulations.<sup>55</sup> Federal rent control terminated on January 11, 1973.<sup>56</sup> There then arose substantial movements in a number of states to continue residential rent controls on a local or statewide basis. In 1973, Maryland's legislature passed a statute<sup>57</sup> (which expired in 1974) limiting rent increases to five percent plus increases in certain costs of the landlord. In the same year, Maine passed a local option law<sup>58</sup> modeled after a similar statute<sup>59</sup> passed by Massachusetts for Boston in 1969. In 1973, Congress enacted a statute authorizing rent control in the District of Columbia.<sup>60</sup> Local rent control is now prevalent in Massachusetts, New York, New Jersey, California and elsewhere, and is probably destined to continue to grow.

## 2. *Federal Case Law on Rent Control*

In an era where state economic regulation of business was under severe challenge as a denial of due process, it is natural that rent control was also seriously contested. Thus in 1921, soon after rent controls were first introduced in the United States during and after World War I, the United States Supreme Court had occasion to rule upon their validity in the famous case of *Block v. Hirsh*.<sup>61</sup> There a D.C. landlord sought to evict a tenant upon expiration of his lease. Under a temporary rent control statute passed in D.C. in 1919, the tenant had a right to possession notwithstanding the expiration so long as he continued to pay the original rent. However, the amount of the rent could be modified by a commission set up for that purpose. The landlord argued that the statute forbidding the eviction was unconstitutional. In upholding the statute, the United States Supreme Court, in an opinion by Justice Holmes, held that the housing emergency caused by the recent war had so clothed the rental housing business with a "public interest" that a temporary control of rents was justified. The Court also hinted that the law, though valid as a temporary emergency measure,

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54. Exec. Order No. 11,615, 3 C.F.R. 199 (1971) (superseded 1971).

55. 6 C.F.R. § 301.102 (1972).

56. Exec. Order No. 11,695, 3A C.F.R. 150 (1973) (revoked 1974).

57. Act of May 24, 1973, ch. 794, 1973 Md. Laws 1651 (expired 1974).

58. ME. REV. STAT. ANN. tit. 30, §§ 5371-5376 (1978).

59. Act of Aug. 24, 1969, ch. 797, 1969 Mass. Acts 726.

60. District of Columbia Rent Control Act of 1973, Pub. L. No. 93-157, 87 Stat. 623.

61. 256 U.S. 135 (1921).

might not be if it were a permanent one. The case was decided against a background of due process case law that forbade state economic regulation of a business unless it was "affected with a public interest."<sup>62</sup> In deciding as it did, however, the Court chose to ignore a doctrine applicable to utility rate regulation which it might have applied by analogy. That doctrine held that the regulated party was entitled, as a matter of due process, to rates sufficient to yield a fair return on the fair value of the assets being used.<sup>63</sup>

In 1934, in *Nebbia v. New York*,<sup>64</sup> a case involving the validity of a New York statute fixing milk prices, the United States Supreme Court abandoned the old substantive due process standard that states could not regulate a business unless it was affected with a public interest. Under the new approach, such regulation would be invalid only if it had no reasonable relation to a proper legislative purpose, or were arbitrary or discriminatory. In 1941, the Court, in *Olsen v. Nebraska ex. rel. Western Reference & Bond Association, Inc.*,<sup>65</sup> specifically held that it was not necessary to show that there was an emergency or that the business was affected with a public interest in order to sustain state regulation of the price an employment agency might charge. The Court said: "We are not concerned . . . with the wisdom, need, or appropriateness of . . . legislation. Differences of opinion on that score suggest a choice which 'should be left where . . . it was left by the Constitution—to the States and to Congress.'"<sup>66</sup>

It would seem that *Nebbia* and *Olsen* together might just as well have been applied to rent control as to price control. Under this view, the emergency requirement of *Block v. Hirsh* as applied to rent control would be deemed overruled by the two later price control cases, and the reasonable relationship to a legitimate legislative purpose approach would have been the standard of review. However, in two subsequent rent control cases, *Bowles v. Willingham*<sup>67</sup> and *Woods v. Cloyd W. Miller Co.*,<sup>68</sup> the Court sustained the regulations as emergency exercises of the war power, in effect de-

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62. *Munn v. Illinois*, 94 U.S. 113, 126 (1876).

63. *Smyth v. Ames*, 169 U.S. 466 (1898). It should be noted that the fair return requirement was later overruled in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). The last case seems to require only that the utility rate not be "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt." *Id.* at 769-70.

64. 291 U.S. 502 (1934).

65. 313 U.S. 236 (1941).

66. *Id.* at 246 (citation omitted).

67. 321 U.S. 503 (1944).

68. 333 U.S. 138 (1948).

clining to deal with the question of whether the *Nebbia* test would apply to peacetime rent control.

The *Nebbia* reasonable relationship test itself was weakened and attenuated over time. The Court tended to give greater and greater deference to state legislative judgments.<sup>69</sup> Finally, in *Ferguson v. Skrupa*,<sup>70</sup> the Court seemed to back away completely from review of economic regulation on substantive due process grounds. It said: "We refuse to sit as a 'superlegislature to weigh the wisdom of legislation'. . . . Whether the legislature takes for its textbook Adam Smith, Herbert Spencer, Lord Keynes, or some other is no concern of ours."<sup>71</sup>

Substantive due process as a federal ground for invalidation of economic regulation was arguably dead.

### 3. *State Case Law on Rent Control and Critique of Courts' Economic Analysis*

Considering all the differing federal approaches over time, it is no wonder that the state courts have adopted a number of varying methods for determining the validity of rent control legislation under substantive due process. Thus there are cases saying that there must be an emergency to justify such an important limitation upon an owner's rights.<sup>72</sup> On the other hand, there are some others that apply the *Nebbia* reasonable relationship test. For example, the California Supreme Court said in *Birkenfeld v. City of Berkeley*:<sup>73</sup> "It is now settled California law that legislation regulating prices or otherwise restricting contractual or property rights is within the police power if its operative provisions are reasonably related to the accomplishment of a legitimate governmental purpose."

Finally, there are courts that have tried to analogize the problem to utility rate regulation. The approach of these is to require that the regulation permit the landlord to get a reasonable return on his investment or on the value of his property.<sup>74</sup> Thus, at the present time there is no coherent and unified body of state or federal law on the subject. The problems of analysis have proved challenging and difficult. I will now turn to a description and cri-

69. *Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483 (1955).

70. 372 U.S. 726 (1963).

71. *Id.* at 731-32 (footnote omitted).

72. *E.g.*, *City of Miami Beach v. Fleetwood Hotel, Inc.*, 261 So. 2d 801 (Fla. 1972).

73. 17 Cal. 3d 129, 158, 550 P.2d 1001, 1022, 130 Cal. Rptr. 465, 496 (1976) (citations and footnotes omitted).

74. *E.g.*, *Troy Hills Village v. Township Council of Parsippany-Troy Hills*, 68 N.J. 604, 350 A.2d 34 (1975). The New Jersey court later modified its position in *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 394 A.2d 65 (1978), discussed in detail below.

tique of the New Jersey situation to show in detail how one court has dealt with these problems. New Jersey is particularly interesting because its very extensive system of rent controls has resulted in a substantial jurisprudence on the subject. The history of how rent controls developed in that state is well described elsewhere.<sup>75</sup> I will limit the historical description here to a short summary.

In 1957, in *Wagner v. Mayor of Newark*,<sup>76</sup> the New Jersey Supreme Court struck down a rent control ordinance of the city of Newark on the grounds that the city did not have the power to enact it under the home-rule act, and that the legislature had, in various laws, evinced an intent to preempt local law and to make rent control a matter of statewide concern. As a result of the holding, no local rent control ordinances were adopted in New Jersey between 1956 and 1971.

The political landscape was completely changed in 1969 with the formation of two powerful tenants' organizations in the state in response to substantially increasing rents. In 1970, the two merged, forming the New Jersey Tenants Organization with a membership estimated at 500,000 under the leadership of one Martin Aranow. At first the organization sought statewide rent control through the legislature. But in 1971 it began seeking rent control on a local basis in spite of the fact that the supreme court decision in *Wagner* seemed to proscribe it. In response to intense political pressure, city councils in a number of New Jersey municipalities, including Fort Lee, enacted "rent leveling" ordinances ("control" apparently having become a dirty word as a result of the disrepute into which New York City's ordinance had fallen). In *Inganamort v. Borough of Fort Lee*,<sup>77</sup> the New Jersey Supreme Court in effect overruled *Wagner* and held that the legislature might constitutionally delegate and did so delegate the power to control rents to municipalities, and that the field had not been preempted by state law. This opened wide the door to rent control on a local basis, and the political atmosphere was more than ripe for its widespread adoption. In the ensuing years, over 100 New Jersey municipalities adopted local rent control, and it is fair to say that the state has become a veritable laboratory for the development and observation of this device in action.

The New Jersey Supreme Court obviously feels that some limit must be placed upon the power to regulate rents, but defining just what that limit should be has proved to be a most demanding task.

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75. Baar, *supra* note 53. The history of New Jersey rent control contained in the text is derived from this source.

76. 24 N.J. 467, 132 A.2d 794 (1957).

77. 62 N.J. 521, 303 A.2d 298 (1973).



Two series of cases in that court show the difficulties it found itself in once rent control became established.

In the first series of cases known as the Trilogy,<sup>78</sup> the New Jersey Supreme Court dealt with the constitutionality as a matter of due process of rent control ordinances in three municipalities. The ordinances in question allowed automatic rent increases up to a specified percentage of the increases in the Consumer Price Index (CPI), and further permitted additional amounts to be granted upon application to a Rent Leveling Board for tax increases, capital improvements, or hardship, where the landlord could not meet mortgage obligations or maintenance costs. An overall ceiling was placed on these increases. In holding the ordinances constitutional as a matter of due process, the court laid down the following principles. First, there is no necessity to justify rent control on the basis of any emergency or that the activity was affected with a public interest.<sup>79</sup> Second, the test of *Nebbia v. New York* governs so that an economic regulation would be invalid on substantive due process grounds only if it had no "reasonable relation to a proper legislative purpose," or was "arbitrary" or "discriminatory."<sup>80</sup> With respect to price regulation, "the question is whether the legislative body could rationally have concluded that the unrestrained operation of the competitive market was not in the public interest."<sup>81</sup> In the rent control area, housing shortages, monopoly power, substandard housing, or housing deterioration would be sufficient justification for the ordinance. The presumption is that the legislative body had such factual support for the ordinance, and since the challenging plaintiff produced no evidence to the contrary, the ordinance must be upheld.

Third, the court held the ordinance must not be confiscatory; that is, it must "permit an economically efficient operator to obtain a 'just and reasonable' return on his investment,"<sup>82</sup> except for temporary emergencies as in war where "all individuals might reasonably be required to make sacrifices for the common weal."<sup>83</sup>

In a long dictum, the court then gave the lower courts guidance to resolve the question of what is confiscation:

[To determine] whether a rent regulation permits a just and reasonable

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78. *Hutton Park Gardens v. Town Council of West Orange*, 68 N.J. 543, 350 A.2d 1 (1975); *Brunetti v. Borough of New Milford*, 68 N.J. 576, 350 A.2d 19 (1975); *Troy Hills Village v. Township Council of Parsippany-Troy Hills*, 68 N.J. 604, 350 A.2d 34 (1975).

79. *Hutton Park Gardens v. Town Council of West Orange*, 68 N.J. 543, 559-60, 350 A.2d 1, 9 (1975).

80. *Id.* at 562-63, 350 A.2d at 11.

81. *Id.* at 564, 350 A.2d at 12.

82. *Id.* at 568, 350 A.2d at 14.

83. *Id.* at 567, 350 A.2d at 14.

return requires consideration of the value of the rental property, the reasonable expense of operating the property, the income, the rate of return on the value of the property actually permitted by the rent regulation, and the minimum rate of return which would be just and reasonable for that property. Basically, this procedure involves two separate stages of calculations. First, the tribunal must make a factual finding as to the rate of return on the value of the property which the landlord will in fact receive under the governing rent leveling ordinance. Second, the tribunal must make a factual determination as to that rate of return below which an actual rate of return would be confiscatory. This second determination can be designated as the "just and reasonable" rate of return on the value of a given rental unit. If the rate of return which the landlord actually receives falls below the just and reasonable rate, then the ordinance must be invalidated as confiscatory.<sup>84</sup>

The court thus borrowed heavily from public utility rate regulation for the general approach to the confiscation problem. That is, it viewed the problem as one of determining rents by applying a percentage fair return to a rate base. However, it turned to real estate appraisal authorities for guidance on how to value the property for rate base purposes. It first noted that the premise of rent control was that the rents were "unfairly inflated" as a result of market failure caused by "housing shortages, monopoly power, etc."<sup>85</sup> (This is a premise subject to some dispute but I will discuss that point later.) The court then pointed out that a valuation based on these inflated rents would quickly defeat the purpose of rent control as it would erroneously cause a court to conclude that a regulation trying to reduce those rents would be confiscatory:

Hence we employ the term "value" in the present context to refer to the value of the property in a rental housing market free of the aberrant forces which led to the imposition of controls. Where inflated rents are the result of a housing shortage, "value" refers to the worth of the property in the context of a hypothetical market in which the supply of available rental housing is just adequate to meet the needs of the various categories of persons actively desiring to rent apartments in the municipality. This technique of hypothesizing a rental market with comparable levels of supply and demand has been utilized in English rent control legislation for several years.<sup>86</sup>

The court then noted that the three principal methods of valuing property were all inadequate to the rate-making purpose. First, the method of capitalizing income, which is the one most commonly used in the market place, is circular when used for determining the proper rent because it begins with a prediction of that future rental income to determine value. Next, market value based on sales of comparable properties is not valid unless the comparable sales are in a rental market that approximates the hy-

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84. *Troy Hills Village v. Township Council of Parsippany-Troy Hills*, 68 N.J. 604, 621-22, 350 A.2d 34, 43 (1975).

85. *Id.* at 623, 350 A.2d at 44.

86. *Id.* at 623-24, 350 A.2d at 44 (citation and footnote omitted).

pothetically adequate market above described. Lastly, the court noted that depreciated replacement cost was "misleading" when the "high cost of construction is a major cause of housing shortages."<sup>87</sup>

The court then left the lower courts completely adrift when it said:

All of these methods, though, may shed light on the value of the property as the term is used here, once their deficiencies are recognized. In determining value, the court should take full advantage of the enlightenment which these methods of valuation may provide, as well as that provided by any other soundly conceived method which the parties and their expert witnesses may suggest such as assessed valuation or original cost depreciated.<sup>88</sup>

When the issue of confiscation finally came up in a real case three years later, the inadequacies of its prescription by dictum in the Trilogy cases impressed themselves on the court. In *Helmsey v. Borough of Fort Lee*,<sup>89</sup> the city ordinance allowed annual automatic rent increases equal to the percentage increase in the Consumer Price Index but not exceeding two and one-half percent, plus a tax increase pass-through. In challenging the ordinance as confiscatory, plaintiffs, major landlords in the town, introduced two kinds of evidence. First, they showed a history since rent controls were imposed five years earlier of slightly declining net operating incomes in thirty-five multiple family buildings with 7,542 apartments comprising eighty-five percent of the rental units in the town. Plaintiffs then projected what would happen to income if rent increases continued to be limited to two and one-half percent and inflation continued at the then substantially higher rate. Second, plaintiffs tried to comply with the formula outlined in the Trilogy cases. The expert witnesses were required by those cases to value the property as if they were in a "hypothetical housing market where supply and demand are in equilibrium"<sup>90</sup>—whatever that phrase means. None of the witnesses had done any such thing before and the appraisal results apparently did not impress the judges. The court said that such valuations would have to be based on comparable sales in other towns without rent control or in the town in question before there was rent control because "rent control would not be necessary if the housing market were in equilibrium."<sup>91</sup> Since the witnesses did not base their appraisals on any such comparable sales, the result did not comply with the requirements laid down in the earlier cases. Further, the court

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87. *Id.* at 626, 350 A.2d at 45.

88. *Id.* at 626, 350 A.2d at 45-46 (citation omitted).

89. 78 N.J. 200, 394 A.2d 65 (1978).

90. *Id.* at 215, 394 A.2d at 72.

91. *Id.*

noted, laying the foundation of comparability would be "difficult and expensive"<sup>92</sup> and so it gave up on using value as the basis for control as being "practically unworkable"<sup>93</sup> and turned to a new criterion using readily obtainable figures.

The court's new approach was to assume that the landlords' net operating incomes (NOI) in 1973 were "fair," and to proscribe a rent control system that caused too much of a decrease of that income. "At some point, steady erosion of NOI becomes confiscatory."<sup>94</sup> The court did not define exactly where that point was, but said that the one to five percent erosion of net operating incomes from 1973 to 1976, while the Consumer Price Index went up thirty percent, was not sufficient to be deemed confiscatory. Next, the court took a great leap. It noted the recent high inflation and *sub silentio* assumed that it would continue into the future. Under such circumstances, the court held, "the 'average' landlord [could] expect profits to fall for the indefinite future"<sup>95</sup> and this would be confiscatory. That coupled with the fact that the procedures for hardship relief were too slow to be effective rendered the two and one-half percent limitation invalid. The latter provision was severable from the rest of the ordinance, however. This left effective the prohibition on rent increases in excess of the percentage increases in the Consumer Price Index.

There are several aspects of the New Jersey decisions that are deserving of comment and criticism. They relate to the court's misconceptions about economics and markets. To begin with, its justification for rent controls is "that rents are being unfairly inflated as a result of failure in the free operation of the rental housing market—e.g., housing shortages, monopoly power, etc."<sup>96</sup> That statement contains a number of doubtful premises which should be explored. One is that numerous landlords of thousands of dwellings in a residential market have monopoly power. Of course, it is monopoly power that justifies price regulation in the public utility area. But the court nowhere states how it concludes landlords have such power in view of their great number. The monopoly notion at first blush therefore seems absurd. Professor Curtis Berger has argued that there is a quasi-monopoly in the residential market because of the relative immobility of the tenant who must pay substantial costs in order to move and who will

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92. *Id.*

93. *Id.*

94. *Id.* at 223, 394 A.2d at 76 (footnote omitted).

95. *Id.*

96. *Troy Hills Village v. Township Council of Parsippany-Troy Hills*, 68 N.J. 604, 623, 350 A.2d 34, 44 (1975).

thereby be impelled to stay if the landlord increases the rent.<sup>97</sup> To talk about tenant immobility in a country where twenty percent of the families move every year and a much greater proportion of tenants does so is questionable to say the least. If American landlords have monopolies, then competition does not exist in any place in the economy.

A second doubtful premise is that "unfairly" high rents are a result of "market failure."<sup>98</sup> The function of a market is to balance supply and demand through the pricing mechanism. If prices go down, more persons will demand the good and less will be supplied. If prices go up, more persons will be induced to produce and supply the good and fewer will demand it. Increased supply resulting from higher prices will in the long run tend to keep the price down. Increasing rents therefore are not the result of market failure but represent the normal functioning of the market whose purpose is to keep supply and demand in balance. To call such rents "unfair" and therefore limit them is to cause the very imbalances that the regulators seek to prevent. By limiting rents more persons will be induced to use more space than they would if the price were higher and fewer landlords will be induced to build new housing. The result is a "housing shortage" which nobody wants to remedy—witness New York City. The court's statement that housing shortages are caused by market failure has it just backwards. It is the operation of the market that will in the long run increase housing supply, and it is rent control that will in the long run cause suppliers to refrain from building more housing.

A related error in the court's opinions is its proposed reliance for valuation on a hypothetical market "in which the supply of available rental housing is just adequate to meet the needs of the various categories of persons actively desiring to rent apartments in the municipality."<sup>99</sup> This betrays the very same misunderstanding about markets. The premise of the "hypothetical market" is that it is only with such a situation that the supply of and demand for local housing would be in balance. That is just not true. Again, it is the function of the pricing mechanism of any market to keep supply and demand in balance, and that is exactly what existed in the New Jersey housing market when rent controls were adopted. Huge numbers of people were not living on the streets in that state. It was not the imbalance of the market that rent control advocates abhorred but the increasing rents. What rent control does is to prevent the market's pricing mechanism from reducing effec-

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97. C. Berger, *supra* note 2, at 239.

98. Troy Hills Village v. Township Council of Parsippany-Troy Hills, 68 N.J. 604, 623, 350 A.2d 34, 44 (1975).

99. *Id.* at 624, 350 A.2d at 44.

tive demand and inducing additional supply. Seen in this light, the court's remark that since vacancy rates dropped under Fort Lee's rent control ordinance, this provides a rational basis for continued rent control,<sup>100</sup> is absurd. Naturally vacancy rates dropped as rents were artificially held down. If the untoward results of rent control provide a legal argument for its continuance, then we are indeed in a sad state.

One other point about the court's opinions ought to be mentioned. At one place it said that valuation of the properties is difficult because "[i]n practice, unfortunately, arms'-length sales of rent controlled apartment buildings are rare."<sup>101</sup> Why does the court think that such sales are rare? Does it occur to the judges that there are very few investors who want to own apartment buildings that are very subject to rent controls, and therefore there is not much of a market to buy or construct them? And would this not in the long run mean less rental housing? In answer, one should concede that that is probably not a reason for a court to strike down rent controls, but it certainly should be a reason for a legislative body not to enact them in the first place.

#### 4. *Eviction Control*

Rent control is invariably accompanied by some form of eviction control. This was true of the federal controls during World War II and it is just as true of today's local ordinances. The reason for this is clear. Most residential tenancies are short, *i.e.*, month to month or at most a year in duration. If the landlord could evict the tenant at the expiration of the term, this would give him tremendous leverage to extract a higher unlawful rent in return for renewal. Thus, rent control would be unworkable without controlling the right to refuse renewal. As Mr. Justice Holmes said in *Block v. Hirsh*:<sup>102</sup> "The preference given to the tenant in possession is an almost necessary incident of the policy [to limit landlords to reasonable rents] and is traditional in English law. If the tenant remained subject to the landlord's power to evict, the attempt to limit the landlord's demands would fail."

Typically then a rent control ordinance prevents a landlord from evicting his tenant even at the expiration of the term except for certain reasons specifically described in the law. Such reasons often include: (1) failure to pay rent; (2) tenant's violation of other obligations of the lease; (3) tenant's commission of a nui-

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100. *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 210, 394 A.2d 65, 69 (1978).

101. *Id.* at 214, 394 A.2d at 72.

102. 256 U.S. 135, 157-58 (1921).

sance; (4) landlord's desire to occupy the premises himself; and (5) landlord's desire to abandon or demolish the property.

Under these laws, the landlord no longer can exercise the same kind of control over the identity of his tenantry as he could at common law. In these circumstances, it is not much of an overstatement to say that once a person has rented property for a month, he is in effect entitled to an estate for his life if he pays the lawful rent and does nothing culpable with respect to the leased property.

The inextricable relationship between regulation of rents and evictions is demonstrated in the recent, apparently revolutionary, eviction control statute in New Jersey.<sup>103</sup> The new statute is unlike most rent control laws whose primary mechanism is control of rents by an administrative agency aided by a set of rules prohibiting eviction except for cause. Rather, New Jersey's new law prohibits evictions except for good cause, and then, as an adjunct, in effect sets up a rent control program administered by the regular courts if there is no system of local rent control. It does this by prescribing as good cause for eviction a failure "to pay rent after a valid notice to quit and notice of increase of said rent, provided the increase in rent is not unconscionable and complies with any and all other laws or municipal ordinances governing rent increases."<sup>104</sup> Another related good cause is the situation where "[t]he landlord or owner proposes, at the termination of a lease, reasonable changes of substance in the terms and conditions of the lease . . . which the tenant, after written notice, refuses to accept."<sup>105</sup>

Since the statute sets up no machinery for determining what is an unconscionable or unreasonable rent increase where there is no local rent ordinance, it is the courts who will have to decide that question on a case by case basis. What the statute did was to set up through the backdoor a state-wide court-administered rent control system. However, since so many towns in New Jersey already have local rent and eviction control, it may be that the rent control aspect of the state law will not be used all that much. Certainly the cases that have been officially reported under the Act thus far have not involved rent disputes, with just one exception; and that case involved an HUD financed project where rent controls were federally preempted.<sup>106</sup>

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103. N.J. STAT. ANN. §§ 2A:18-61.1 to -61.5 (West Supp. 1980).

104. *Id.* § 2A:18-61.1(f).

105. *Id.* § 2A:18-61.1(i).

106. *Hill Manor Apartments v. Brome*, 164 N.J. Super. 295, 395 A.2d 1307 (Essex County Ct. 1978).

## 5. *Policy Analysis of Rent Control*

### a. *Fairness*

I use as the fundamental criterion for the fairness of these new regulatory impositions, such as rent control, the question of whether the law is operating upon the landlord in a retroactive or unexpected way. If it is not, then the landlord will be in a position to protect himself by bargaining on terms with the tenant, or by an upward adjustment of rent in exchange for the new right, or in some other fashion. But if the law operates in such a way that the tenant is unexpectedly or retroactively granted substantial new rights, and the landlord is by circumstances or design prevented from recouping losses caused by the newly created disadvantage, this may be said to be unfair to him. This expectation notion of fairness was recently more fully developed in my article on takings,<sup>107</sup> and is based partially on Edmund Cahn's ruminations about the sense of injustice in his famous book.<sup>108</sup>

Can rent control be said to be in that sense unfair to landlords? It seems that the answer to that question should depend upon what law existed or was reasonably expected at the time the landlord originally invested in his property. If rent control existed or was contemplated at that time, the price he paid for the property would reflect that, and it would be difficult to argue that rent control was an unfair imposition upon him. But where there was no rent control and none was contemplated at the time of his investment, he would have paid a full price for the asset and a subsequent enactment of such a law would seem to be most unfair. In the long run, therefore, it would appear that a well-established set of rent controls would be discounted in the market by lower prices paid for purchase of rental property and the landlord could and would avoid any unfairness arguably stemming from the law.

### b. *Economic Efficiency*

As a matter of economic efficiency, rent controls are much more suspect, however, as the foregoing discussion of the case law on the subject demonstrates. Several additional points should be made as well. First, it is ironic that price control in the form of numerous rent control ordinances and statutes has been recently imposed on the very sector of the economy that has shown the lowest rate of inflation of the major components of the Consumer Price Index.<sup>109</sup> The trend toward rent control is nevertheless un-

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107. See L. Berger, *A Policy Analysis of the Taking Problem*, 49 N.Y.U. L. REV. 165, 166-69 (1974).

108. E. CAHN, *THE SENSE OF INJUSTICE* 13-22 (1949).

109. From the 1967 base period to November, 1980, the Consumer Price Index went



mistakable and it is strong. A number of factors explain this, but I would suggest that the major explanation lies in the fact that the market for rental properties is local and therefore subject to relatively effective local regulation. In contrast, if the consumers in the town of X are unhappy with the rising price of food, there is no way they can effectively procure laws which will relieve their problem. If the town were to freeze the prices the local food stores could charge, the latter would continue in business for only a very short time. As soon as their costs exceeded their revenues they would be inclined to close down and their customers would travel to a neighboring town to buy food at market prices. Local price regulation of items traded on a national market could not possibly be effective.

But where the market is local—in the sense that the thing to be sold cannot be moved in response to higher prices elsewhere—local price regulation is feasible. It is the feasibility of local rent control that explains its rapid growth. Consumers, frustrated by their inability to keep up with the rising cost of living, naturally turn to local government to solve those problems it is capable of solving. Wherever tenants form a large percentage of the local population, local officeholders are subject to pressure for rent control. And as already noted, a large number of municipalities have recently responded affirmatively, especially in a few of the larger states.

What will continued rent control bring to these American cities in the long run? The answer is demonstrated in New York City, Britain, Paris and elsewhere. Though keeping price down does not restrict housing supply in the short run because the buildings are already in existence, the long run effects are devastating. Very few investors want to build housing for rental in a rent-controlled environment when they can invest in uncontrolled sectors of the economy. For example, as a result of rent control in Britain the private rental sector declined from sixty-one percent of the dwellings in 1947, to only fourteen percent in 1977.<sup>110</sup> Private investment in rental housing other than luxury units has practically ceased there. The government is now the builder of rental housing in Britain, as it must be in any economy where rent control continues to discourage private investment. In Paris, rent-controlled apartments were vacated only when the occupants died, and it is said that for many young couples "the wife's major activity consist[ed] of watching out for deaths"<sup>111</sup> so that she could find a vacated apartment.

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up 148% while the rental component thereof went up 92%. U.S. BUREAU OF LABOR STATISTICS, DEP'T OF LABOR.

110. See Utt, *supra* note 53, at 88.

111. *Id.*

Besides helping to create shortfalls in construction, rent controls tend to increase the dilapidation and abandonment of rental property as increasing costs narrow the landlord's margin of return and make continued maintenance or operation unprofitable. In addition, rent controls encourage the inefficient allocation of housing by causing persons to stay in larger premises than they need after reduction in the size of their family.

Finally, it can be argued that since rent control makes operation of housing relatively unprofitable, it will cause owners to take the housing off the rental market and sell it to owner-occupants. This occurs not only with respect to single-family dwellings but also to large buildings where condominium conversion is becoming more and more of a problem. That is not to say that such conversions take place only where there is rent control; that is not true. They take place wherever operation of rental housing is unprofitable and there is a strong market for owner-occupied housing. Nevertheless, a rent-controlled environment creates a strong incentive toward taking properties off the rental market. For those interested in achieving both high quality and quantity of rental housing, such a result must be seen as terribly destructive.

### C. Control of Entry Into and Withdrawal From the Market Versus Condominium Conversion Legislation

#### 1. *The Background*

Public utilities are regulated with respect to who may enter or withdraw from a given market. The requirement of a franchise, license, or certificate of public convenience and necessity is the means used to control entry. Several justifications for this type of regulation have been stated by Professor Kahn.<sup>112</sup>

First, where the industry is a natural monopoly, the customers can be served at the lowest cost by one firm or a very limited number of firms. If unrestricted entry were allowed, there would be "cycles of excessive investment followed by destructive rivalry"<sup>113</sup> which would drive prices so low that the companies would not be able to maintain their equipment or give adequate service.

Second, most public utilities need eminent domain to perform their services—railroads need roadbeds and electric companies need easements to run lines—and government must dispense this

112. See 2 A. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 2-11 (1971). This book serves as the source for the discussion of public utility regulation contained in the text.

113. *Id.* at 2.

power in such a way as to eliminate wasteful duplication. This justification is really a derivative of the notion of natural monopoly—that it is more efficient to have one entity tear up the streets than ten.

Other perhaps less important reasons have been posed by Professor Kahn for entry regulation: (1) to encourage private investment in a highly risky field by giving a monopoly; (2) to limit the entry into a field to those with sufficient skill; (3) to prevent discriminatory pricing; and (4) to prevent entry into only the lucrative markets.

There is as yet no completely analogous regulation of entry into the landlord business. Of course land use controls can and do affect whether an owner can build rental housing on a particular parcel. But aside from such indirect methods, there is no real regulation of a person's right to rent out his property. Certainly if one examines the above-mentioned justifications for entry regulation of public utilities, no reason appears for similar regulation of landlords.

The right of a public utility to withdraw service from customers is often regulated. The major justification is that once a monopoly is granted to a particular company it is unfair for it to serve only the profitable portion of the market; rather, in return for its government-granted monopoly, its obligation is to serve all in the market needing the service. Thus, airlines and railroads historically have been ordered to continue services to places or types of activities they would have preferred to abandon.

The situation in the landlord-tenant area analogous to regulation of withdrawal would be a governmental attempt to prevent a landlord from withdrawing his property from the rental market. This has actually occurred in two situations: (1) where a landlord seeks to evict, purportedly to take the property off the market, but really as a means of retaliation for the tenant's reporting of code violations; and (2) regulation of condominium conversions. The first item is of relatively little importance. There are a few cases that in effect prevent a landlord from taking his property off the rental market when used as a pretext for "getting even" with his tenant.<sup>114</sup> The second item is of great interest, and in the scheme of things, more important. It involves the general question of whether an owner may decide to stop renting his property and to offer it for sale to owner-occupants without stringent regulation of such activity. The answer increasingly given by the law is that he

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114. *Robinson v. Diamond Housing Corp.*, 463 F.2d 853 (D.C. Cir. 1972); *Silberg v. Lipscomb*, 117 N.J. Super. 491, 285 A.2d 86 (Union County Ct. 1971).

may not, as my discussion of anti-condominium conversion legislation will show.

## 2. *Anti-Condominium Conversion Legislation*<sup>115</sup>

In the past five years, there has been a tremendous growth in the number of conversions of rental apartments to condominium ownership. It has been estimated by Advance Mortgage Corporation that there were 45,000 such conversions in 1977, 85,000 in 1978, 145,000 in 1979, and 160,000 in 1980.<sup>116</sup> The hot pace continued through 1980, but the money shortage and high interest rates of the past months may have slowed the activity. However, it is expected that when money becomes more readily available at reasonable rates, the volume will pick up to even higher levels.

A number of factors have contributed to the remarkable growth of this activity. Ever tightening rules about depreciation and depreciation recapture have made purchases of rental housing less attractive for tax purposes, thus reducing the apartment resale market. In addition, rental income has not kept up with costs.<sup>117</sup> Since the resale price of rental property is completely tied to, and is a function of, the amount of net operating income that the property earns and since net operating incomes have been decreasing, additional downward pressure has been placed on the value of rental property. Rent control has exacerbated this problem. It is estimated that in New York City, the value of rent-controlled buildings has declined from about six to eight times annual rents to about one and one-half times.<sup>118</sup> Even where there is no rent control, however, the price that a building can bring subdivided as a condominium has averaged about one and one-half to two times

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115. On this general subject see U.S. DEP'T OF HOUSING AND URBAN DEVELOPMENT, *THE CONVERSION OF RENTAL HOUSING TO CONDOMINIUMS AND COOPERATIVES* (1980), reprinted in G. STERNLIEB & J. HUGHES, *THE FUTURE OF RENTAL HOUSING* 122 (1981); Wynn, *Condominium Conversion and Tenant Rights—Wisconsin Statutes Section 703.08: What Kind of Protection Does It Really Provide?*, 63 MARQ. L. REV. 73 (1979); Comment, *Conversion of Apartments to Condominiums: Social and Economic Regulations Under the California Subdivision Map Act*, 16 CAL. W.L. REV. 466 (1980); Comment, *The Regulation of Rental Apartment Conversions*, 8 FORDHAM URB. L.J. 507 (1980); Note, *The Validity of Ordinances Limiting Condominium Conversion*, 78 MICH. L. REV. 124 (1979); Note, *Condominium Conversion Legislation: Limitation on Use or Deprivation of Rights?—A Re-examination*, 15 NEW ENG. L. REV. 815 (1980); Note, *Conversion of Apartments to Condominiums and Cooperatives: Protecting Tenants in New York*, 8 U. MICH. J.L. REF. 705 (1975).

116. See 2 Real Est. Outlook 1 (May 1980); Telephone interview with Advance Mortgage Corp.

117. See note 109 *supra*.

118. See Utt, *supra* note 53, at 90.

the price that it can bring as the sale of rental property.<sup>119</sup> This economic fact is perhaps the biggest single factor leading toward condominium conversions. In addition, new trends protective of tenants, *e.g.*, strict habitability enforcement, anti-eviction laws, and tenant unions, have made being a landlord less attractive than ever.

While all this has been going on, there has continued to be a huge demand for owner-occupied housing. The advantages of home ownership include the income tax deductibility of real estate taxes and mortgage interest, the possible appreciation in value of the house, protection from inflation in rents, and the right to permanent control of the property. With prices of single-family dwellings escalating out of sight, the lower prices that condominium housing commands has made the latter most attractive as an alternative means of owning a home. The confluence of the two factors of increased financial incentives to market the apartments and increased demand for them has made condominium conversion one of the remarkable new developments of the seventies and eighties.

This trend, as might have been expected, has not been an un-mixed blessing. Every time a rental apartment unit is converted and sold to a non-tenant, a tenant is forced out of his dwelling. Of course the person buying it is vacating housing as well, so any claims that a housing shortage is being created by conversions are patently absurd. Nevertheless, a decrease in the overall amount of rental housing does result, unless new construction makes up for the loss, and very little such construction has been going on. So it is fair to say that conversions do adversely affect the supply of rental housing and this hits particularly hard those of lower income in our society who cannot afford to buy the property they rent. Even tenants who can afford to and do buy their apartments have grievances however. Many are unwilling buyers who purchase because of their fear of eviction. Moreover, the monthly payments they are required to make on the new mortgages financing the purchases often are one and one-half to three times higher than their former rents, even after substantial down payments.<sup>120</sup>

Inevitably, then, tenants have brought political pressure upon federal, state, and local government for measures to slow down or even to stop the conversions. The response has been a large number of laws at all three levels designed in different ways to

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119. See 2 Real Est. Outlook 1 (May 1980); Note, *Conversion of Apartments to Condominiums and Cooperatives: Protecting Tenants in New York*, 8 U. MICH. J.L. REF. 705 (1975).

120. See Rugaber, *Condominium Trend Cuts Rental Market*, N.Y. Times, Sept. 28, 1974, at 1, col. 5.

stem the tide.<sup>121</sup> These laws fall into a number of categories:

(1) *The Moratorium*. Typically, such legislation is passed to give the governing entity enough time to study the conversion problem so that other effective laws can be passed. In 1979 Chicago passed a forty day moratorium<sup>122</sup> and Philadelphia an eighteen month one.<sup>123</sup> The latter city, at the same time, enacted a number of other measures protective of tenants of condominium converters.

(2) *Relocation Assistance and Payments*. A number of jurisdictions have provided that the converter must assist tenants displaced by the conversion to find housing and pay them either the cost of moving or a fixed sum in lieu thereof.<sup>124</sup> A New Jersey statute requires that the converter upon request "shall offer to the tenant, personally or through an agent, the rental of comparable housing and a reasonable opportunity to examine and rent such comparable housing."<sup>125</sup> No tenant can be removed without three years' notice<sup>126</sup> and without proving the above offer was made. The tenant is entitled to up to five one-year stays of eviction until the court is satisfied that the tenant has been offered the comparable housing. After the first one-year stay, the landlord can avoid the offer requirement and further stays by paying the tenant five months' rent.<sup>127</sup> But under New Jersey law, the three-year notice provision delays conversion against an unwilling tenant for a very substantial time.

(3) *Right of First Refusal*. Some legislation requires that the tenant be given a right of first refusal with respect to the apart-

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121. The state and local laws will be discussed below. In 1980 Congress passed the Condominium and Cooperative Abuse Relief Act. Condominium and Cooperative Abuse Relief Act of 1980, 15 U.S.C.A. §§ 3601-3616 (West Supp. 1975-1980). The Act is hortatory only and will not be elsewhere discussed in this article. The act merely *recommends* that state and local law provide tenants with notice and opportunity to purchase. *Id.* § 3605. There is continuing pressure for stronger federal legislation including a two year absolute moratorium on all conversions.

122. Chicago, Ill., Temporary Moratorium on Condominium Conversion (March 21, 1979), *noted in Comment, The Regulation of Rental Apartment Conversions*, 8 *FORDHAM URB. L.J.* 507, 517 n.46 (1979-1980).

123. PHILADELPHIA, PA., CODE §§ 9-1201 to -1208 (1979), *noted in Comment, supra* note 122, at 517 n.46.

124. *See, e.g.,* LOS ANGELES, CAL., CODE § 47.06, *noted in Comment, supra* note 122, at 561 n.351. This Act requires relocation assistance or payment of \$2500 in lieu thereof to "qualified tenants" as defined. *Id.*

125. N.J. REV. STAT. § 2A:18-61.11 (West Supp. 1980).

126. *Id.* § 2A:18-61.2(g).

127. *Id.* § 2A:18-61.11.

ment he occupies, but makes no attempt to affect the price. Virginia has such a statute, giving the tenant sixty days after notice to decide whether to purchase.<sup>128</sup> California<sup>129</sup> and Florida<sup>130</sup> have similar provisions.

(4) *Limitation on Number of Conversions.* Some jurisdictions limit the number of conversions that may take place. For example, a San Francisco ordinance limits the number of rental units that may be converted in a year to 1,000.<sup>131</sup> Other jurisdictions forbid conversions if the vacancy rate for relevant rentals falls below a certain percentage.<sup>132</sup>

(5) *Tenant Purchase Requirements.* Under the laws of certain jurisdictions, a required percentage of tenants must agree to purchase their apartments before the eviction of non-purchasing tenants will be permitted. New York City has the best known such provision. The details differ according to whether the apartment comes under the local "rent control" or "rent stabilization" ordinance; but the major provisions are similar. Under the city's rent control ordinance,<sup>133</sup> in order for a conversion plan to be declared effective by the Attorney General, at least thirty-five percent of the tenants in possession must agree to purchase their apartments. After the plan is declared effective, the non-purchasing tenants are given rights of first refusal at the previously offered terms, or if the later terms are more favorable, at those terms. A non-purchasing tenant has substantial long-term protection, in that after his apartment is sold, he cannot be evicted for the next two years unless eighty percent of the apartments in the building have been sold to tenants. Tenants age sixty-two or older are given special protection against eviction by state statute.

Converters can avoid the thirty-five percent rule by going to a non-eviction plan. Under this option, which is not specifically provided for by law, they can convert apartments to condominiums but may not evict non-purchasing tenants. Buildings under this

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128. VA. CODE § 55-79.94 (1981).

129. CAL. GOV'T CODE § 66427.1(a) (West Supp. 1966-1980).

130. FLA. STAT. ANN. § 718.612 (West Supp. 1980).

131. SAN FRANCISCO CAL., MUN. CODE art. 9, § 1396 (1979), *noted in* Comment, *supra* note 122, at 561 n.349.

132. D.C. CODE ANN. § 5-1281(b)(1)(B) (Supp. V 1978) (vacancy rate of the building three percent or less); LOS ANGELES, CAL., CODE § 125.2(F6) (1979) (vacancy rate of the planning area in which property is located five percent or less), *noted in* Comment, *Conversion of Apartments to Condominiums: Social and Economic Regulations under the California Subdivision Map Act*, 16 Cal. W.L. Rev. 466, 490 nn.122 & 123 (1980).

133. NEW YORK, N.Y., ADMIN. CODE §§ Y 51-1.0 to -18.0 (1975 & Supp. 1979), *noted in* Comment, *supra* note 122, at 544 n.236.

plan tend to remain hybrid, as many tenants choose to stay in their apartments.

### 3. *Policy Analysis of Condominium Conversion Legislation*

#### a. *Fairness*

It should be observed initially that some of the minor anti-conversion laws do not really harm owners to any great degree. The short moratorium probably does no substantial damage except to the extent that it enables the regulators to prepare and pass more onerous laws. And it is hard to argue that owners are hurt by provisions that give the present tenant some notice and a right of first refusal to buy his dwelling at the market price. After all, the owner is getting his price. The only parties who could arguably be damaged would be the indefinite universe of non-tenants who might desire to buy the tenant's apartment. But their claim seems relatively tenuous, and first refusal seems a thoroughly justifiable kind of regulation.

Some of the other laws, however, impose very large costs. Consider the ones requiring that the converter pay moving costs to the evicted tenant.<sup>134</sup> The converter must pay even though the tenant's term is up, and he, in the past, would have had no right to stay beyond his term. This kind of regulation relates to the previously mentioned trend in rent-controlled areas to give essentially a life estate to all residential tenants who perform their lease obligations faithfully. In the conversion case, it might appear at first glance as if the cost of relocation were being shifted from the tenant to the converter. However, this might not necessarily be true. Depending upon the extent of competition between condominium conversion properties and other properties for sale, it might be possible for the converter to shift the cost to the apartment buyer by increasing price. The question then becomes: who ought to bear the cost of the tenant's relocation, the converter, his purchaser, or the tenant himself?

As a matter of fairness or equity, the answer should depend upon what the reasonable expectations of the tenant were upon the original leasing. If the relocation expense law was on the books at that time, and if the rents charged in the locality reflect that additional cost of operation (that is, there is no rent control), it would not be unfair to require the landlord to pay for relocation. If no such law existed or if such a law existed but was accompanied by rent control, it would be unfair to charge the landlord for the tenant's relocation costs because the former would not have been in a position to charge increased rentals in return for that

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134. See notes 124-27 & accompanying text *supra*.



right, and he might not be able to recoup such costs from a buyer in a very competitive market.

The same analysis would apply to the other stringent regulations such as the tenant purchase requirements or the limitation on the number of conversions in a year. Again, if the law were in effect at the time the lease was entered into, and if the rents charged were permitted to reflect the additional rights granted by that law, it probably should not be considered unfair to allow the law to operate. All of the above discussion rests, of course, on two premises: (1) that rents are not controlled, and (2) that rents will rise if the law grants additional rights to tenants limiting the owner's right to convert. The second point may be doubtful for the short run, because the supply of rental housing is already on the market, and raising rents would be difficult if more tenants are not seeking housing. On the other hand even in the short run, there might be more new households choosing to rent rather than to buy because the rights of tenants were being substantially increased by the law; rents therefore might be raised. In the long run, there is little doubt that rents would increase as a result of these anti-conversion laws. In the face of such statutes, fewer persons would be induced to construct rentals and this would limit supply. At the same time, renting would be more attractive to persons seeking housing and this would increase demand. In the long run, therefore, it is difficult to argue that these laws are "unfair" to landlords unless they are accompanied by rent controls.

#### *b. Economic Efficiency*

I will turn now to an analysis of the condominium conversion laws as a matter of economic efficiency. For the purpose of discussion assume the following facts. O is the owner of an apartment building with 100 units. Each apartment yields a rent of \$400 per month. Total gross rents are therefore \$480,000 per annum. As a rental building the property is worth \$4,000,000. However, as individual apartments the property is worth \$60,000 per apartment or \$6,000,000. Assume further that if tenants in the building must move, their relocation costs would be \$1,000 each or a total of \$100,000.

A useful analysis of the general problem of efficiency and appropriate remedies was developed by Professor Calabresi in a recent article.<sup>135</sup> If one applied that analysis to a dispute between a condominium converter and his tenants, four possible combinations of remedy would appear. First, the owner might have the ab-

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135. Calabresi & Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

solute right to evict the tenant at the expiration of his term, enforceable by an action for possession. Under this approach, the tenant, in order to stay, would have to pay a price satisfactory to the owner. That is, he would have to pay whatever the market would require for the right he desired. This, of course, was the traditional approach of the law, under which the tenant had absolutely no right to stay beyond the expiration of his term and an action for possession against him lay if he failed to vacate. Second, the law might say that the owner has the right to his property, but enforceable only by a suit for damages. In effect, the tenant could stay as tenant by paying what a court would say was the value of his possession. The true ultimate result of this rule would be to allow the tenant a right to "condemn" a right to rent the property for his life. This is very close to what the law now is in those localities having rent and eviction control laws where the tenant may not be evicted except for cause and rents are strictly regulated by law.

A third possible view would give the tenant a specifically enforceable right to stay on the property. This is a remedy analogous to the first alternative, except here the owner could rid himself of the tenant only by paying what the latter demanded—again a market transaction. Lastly, the law might be that the tenant has a right to stay, but the only remedy he would have for being physically evicted by the owner would be damages for injury to his right of possession.

Specifically enforceable rights which can be overturned only by a market transaction, as in alternatives one and three, Calabresi calls property entitlements. Rights that are enforceable only through a court's determination of value and an award of that value in money, as in alternatives two and four, Calabresi calls liability entitlements.

To those trained in the received tradition of property law, alternatives three and four might seem on their face to be almost preposterous as possible views of what the rules might be; but they are not. Indeed, alternative four is the rule adopted in a number of jurisdictions, in effect giving the tenant the right to overstay his term, his remedy for breach being a right to recover the expenses of his relocation.<sup>136</sup>

The third alternative seems at first blush even more absurd. But in effect, it is the law in New York City. You will recall that under New York's rule, thirty-five percent of the tenants must purchase their dwellings before the Attorney General will declare a conversion plan effective, and without such declaration, no ten-

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136. See notes 124-27 & accompanying text *supra*.

ant may be evicted from his dwelling.<sup>137</sup> Thus, in order to have a plan in which an apartment purchaser may be assured that he can evict the occupant and thereby use it himself, a very substantial number of the tenants in the building must purchase. It is perfectly obvious that this gives a huge amount of leverage to those tenants who can effectively block the conversion by refusing to purchase. And what a position to be in! They live in rent-controlled premises with rents much lower than the market would command. They thus have every incentive to want to continue as tenants. And they can block the conversion to owner-occupied housing if they will just refuse to purchase. The result is that they have a right to stay on the premises where the owner can get rid of them only by paying what they can command in the market. In this particular case what they can so command is a much lower purchase price than others would have to pay in order to buy the premises. They can get this lower price because they are not in a competitive market, but rather in an artificially created monopsonistic one. The effect of all this is that the owner will offer his tenants a substantial discount to induce them to buy so he can reach the thirty-five percent requirement.

Generally speaking, one would measure efficiency by determining which use of the resources would maximize their values. I can therefore start my economic analysis of the above four remedies with the postulate that efficiency calls for the building in the example given to be converted to condominiums because it is worth \$4,000,000 as a rental and \$6,000,000 as owner-occupied housing. This gain of \$2,000,000 is much greater than the tenant relocation costs which total \$100,000. The Coase theorem<sup>138</sup> says that in an unregulated market, no matter which of the four alternative remedies is declared by the law to be applicable, market forces will direct the parties toward the efficient result, unless transaction costs are too high. Assume for purposes of discussion that transaction costs are zero. Thus, under alternatives one and two (owner has a right to evict tenant or to collect damages for his failure to leave), the efficient result would clearly follow. Specific eviction relief would directly effectuate the conversion. And even giving damages would result in the conversion. The damages to the owner would be at least \$20,000 per apartment—the difference between its value as a rental and its value as owner-occupied housing. In that situation, it would not be worth \$20,000 (less \$1,000 relocation costs) to an individual for a right to occupy a rental dwelling for the rest of his life with an obligation to pay the fair rental value as rent. (Of course, if the rents are regulated and held below market,

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137. See note 133 & accompanying text *supra*.

138. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

then the right to occupy would have a value in excess of the rents.) Therefore, the parties would reach a settlement in which the owner would pay the tenant some relatively small amount, perhaps the cost of relocation or a little more, to get him out.

The efficient result of conversion would also occur under alternative remedies three and four (tenant has a specifically enforceable right to stay on the property or can collect damages for being evicted). Again assuming that the tenant would have a continuing obligation to pay market rents, the right to stay on would have a relatively small value to him, perhaps the \$1,000 cost of relocation. But it would be worth \$20,000 to the owner to get rid of him and convert. Therefore, the owner would pay him some amount between \$1,000 and \$20,000 to get his agreement to leave, and conversion would take place whether his rights are specifically enforceable or just in damages.

However, if one changed the figures in the original hypothetical so that the owner made only \$2,000 per apartment by converting, the relocation costs were the same \$1,000, and the transaction costs of negotiation and settlement were \$1,500, the entire picture would change. The efficient result of conversion would occur only when the law followed alternatives one or two (owner has an action for specific recovery of possession or for damages), because giving the tenant the initial entitlement under alternatives three or four would prevent a deal from being made. The reason is that the \$1,500 transaction costs of settlement plus the \$1,000 that the tenant would likely demand for relocation as a minimum, would exceed any increase in value the owner might reap. Therefore, since generally it is not known in advance whether the transaction costs would exceed any economic gains, the economist would argue that for efficiency reasons the law should choose alternative one or two and allow the landlord the initial entitlement. The first alternative is preferable because specific relief encourages the use of the less expensive market transaction rather than the more expensive court proceeding. So the common law rule allowing the landlord recovery of his property at the expiration of a tenancy would tend toward the efficient result. This would also suggest that the other onerous anti-conversion regulations such as tenant purchase requirements, relocation assistance, or long delays in eviction relief, might in many cases also frustrate economic efficiency.

I have yet to discuss in economic terms a regulation limiting the number of conversions to an absolute annual maximum, or forbidding them where rental vacancy rates are low. These laws create what Professor Calabresi would call an inalienable entitlement.<sup>139</sup>

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139. Calabresi & Melamed, *supra* note 135, at 1111-15.

In such a case, "the law not only decides who is to own something and what price is to be paid for it if it is taken or destroyed, but also regulates its sale—by, for example, prescribing preconditions for a valid sale or forbidding a sale altogether."<sup>140</sup> As Calabresi points out, a regulation making an entitlement inalienable may sometimes lead to efficiency. He cites as an example a regulation barring sale of certain realty to polluters where there are many potential injured parties; collective valuation by liability rules would be too expensive, and it is clear that avoiding pollution is cheaper than its costs.

In this case it is apparent that in many if not all cases where the owner seeks conversion, making apartments inalienable by limiting the number of conversions would lead to the inefficient result. Consider my original example where conversion would increase values by \$2,000,000 at a cost of \$100,000 in relocation expenses. Preventing conversion would have immense economic costs. And even where the figures were \$200,000 and \$100,000 respectively, efficiency would call for the conversion to be made. Therefore, it is clear that laws limiting numbers of conversions tend toward economic inefficiency.

In conclusion then, it might be said that although anti-conversion laws unaccompanied by rent and eviction controls might not be deemed unfair to the landlord, the more stringent ones would probably in the long run lead toward inefficiency and misallocation of resources.

#### **D. Regulation of Quality of Service Versus Landlord's Obligation to Supply Habitable Premises**

##### *1. The Background*

Public utility regulators have the power to prescribe rules with respect to quality of service. Typically however, direct regulation of quality is quite limited. As Professor Kahn notes:

But it is far more true of quality of service than of price that the primary responsibility remains with the supplying company instead of with the regulatory agency, and that the agencies, in turn, have devoted much more attention to the latter than to the former. The reasons for this are fairly clear. Service standards are often much more difficult to specify by the promulgation of rules. Where they can be specified, they are often essentially uncontroversial. Where they cannot—and this is particularly the case when it comes to innovations, to the dynamic improvement of service—in a system in which the private companies do the managing and the government the supervision, there is no choice but to leave the initiative with the company itself. The only role the regulatory commission can typically play is a negative one—formulating minimum standards and using periodic inspections to see that they are met; investigating customer

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140. *Id.* at 1111.

complaints and issuing orders when service has been obviously poor, when management or subordinates have been blatantly inefficient or unfair, or when it wishes to insist that the companies take on or retain unremunerative business.

This authority is by no means negligible. The aggressive commission has available to it the ability to penalize offending companies by holding permissible rates at less remunerative levels than it would otherwise be prepared to allow—subject to the constraint, however, that it would be self-defeating to punish them so severely as to impair their financial capacity to institute the desired improvements. And commissions frequently do use this weapon.

Still, their role is essentially a negative one and this raises fundamental questions about the efficacy of the entire process.<sup>141</sup>

The analogy in landlord-tenant law is quite interesting. In many ways regulation of quality is more detailed and stringent in that sphere than it is in public utility law. This is not the place for a detailed treatment of those developments, however, as it has been done many times before. It will suffice to review them here cursorily in outline form as a background for my policy discussion.<sup>142</sup>

1. *Housing Codes.* These are detailed codes enacted generally on a local level. They typically regulate such things as number of persons in occupancy, repair, ventilation, fire safety, heat, hot and cold water, plumbing fixtures, sewage disposal, elevator service and the like. Enforcement is usually by a local agency. They use the following modes of enforcement:

a. An order to vacate. This may be followed by an order to demolish if the owner does not bring the building into compliance within a certain time. These remedies obviously do not work in a period of housing shortage.

b. Criminal prosecutions. These result in small fines but almost never in a jail sentence. The small fines when paid are regarded by the landlords as a cost of doing business.

c. Civil penalties. These are supposedly for the purpose of extracting from the landlord the economic benefits he has unfairly derived from the premises. The cost of prosecuting these civil actions is so high that they have fallen into disuse.

d. Mandatory injunction ordering the repairs. This is

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141. I A. KAHN, *supra* note 46, at 22.

142. The best and most complete up-to-date review of this history may be found in Cunningham, *The New Implied and Statutory Warranties of Habitability in Residential Leases: From Contract to Status*, 16 URB. L. ANN. 1 (1979). The outline in the text is taken from this article.

theoretically a very effective device, but seems to be used only in the city of Chicago.

e. Direct agency action to make repairs. This mode of relief is authorized in a number of states, but is rarely used, probably because of insufficient staff.

f. Receiverships. These laws authorize appointment of a receiver to collect rents and make repairs. There is some evidence that receiverships have been effective in Chicago.<sup>143</sup> They were used in New York City from 1962 to 1965.

2. *Rent Withholding Legislation.* A number of states have passed statutes authorizing tenants to withhold rents where there is a serious violation of a housing code.<sup>144</sup> Typically, rents may be withheld only upon showing that the premises failed an inspection by an appropriate officer. Most of the statutes require that the rents be paid into court or to a housing agency. Some statutes allow the court or agency to use the rents to correct the violations.

3. *Statutory Imposition of Warranty of Habitability.* A number of states passed statutes in the nineteenth century requiring the landlord to put residential premises in tenantable condition fit for occupation.<sup>145</sup> These statutes gave tenants the right to vacate the premises, or to repair and deduct the cost thereof from the rents. Some states limited this last option to a maximum of one month's rent.

More recently, Idaho, Maine, Michigan, Minnesota, New York, Rhode Island and Wisconsin have enacted statutes simply declaring that the landlord must provide habitable dwellings at the beginning of the term.<sup>146</sup> Some statutes also provide for a continuing duty to maintain the premises thereafter. Most of the laws do not provide specific remedies for breach of these obligations, though the Maine and Wisconsin statutes have some provisions on remedy.

A large number of states have passed comprehensive new residential landlord-tenant codes based on the Uniform Residential Landlord and Tenant Act,<sup>147</sup> (hereinafter URLTA) or the Model Residential Landlord-Tenant Code.<sup>148</sup> URLTA imposes duties to

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143. *Id.* at 22-23.

144. *Id.* at 23-51.

145. *Id.* at 51-59. The states were California, Georgia, Louisiana, Montana, Oklahoma, North Dakota, and South Dakota.

146. *Id.* at 59-65.

147. *Id.* at 65-74. These states are Alaska, Arizona, Connecticut, Florida, Iowa, Kansas, Kentucky, Montana, Nebraska, New Mexico, Ohio, Oregon, Tennessee, Virginia, and Washington.

148. *Id.* These states are Delaware and Hawaii.

comply with applicable housing codes materially affecting health and safety, and to make all repairs necessary to put and keep the premises in fit and habitable condition.<sup>149</sup>

Professor Cunningham describes the relief available under URLTA as follows:

The URLTA provides a wide variety of remedies if the landlord violates any of his statutory duties with respect to the condition of the premises. These remedies include termination of the lease if the breach materially affects health and safety, recovery of damages, injunctive relief, the right to repair minor defects in the dwelling unit and to deduct the cost of repairs from the rent, where there is wrongful failure to supply heat, water, or essential services, the right to "procure reasonable amounts" of the same "and deduct their actual and reasonable cost from the rent," or "procure reasonable substitute housing during the period of the landlord's noncompliance, in which case the tenant is excused from paying rent for the period of . . . noncompliance," and use of a counterclaim for damages based on the landlord's breach of duty as a defense to any action by the landlord to evict the tenant or recover rent, subject to the court's power to "order the tenant to pay into court all or part of the rent accrued and thereafter accruing, and . . . determine the amount due to each party" and to enter judgment for the tenant in an eviction action "[i]f no rent remains due after" the net amount owing from one to the other is paid. The last remedy implicitly authorizes the tenant to withhold rent when the landlord violates his statutory duties with respect to maintaining the leased premises in a habitable condition. There is no provision in the URLTA for use of withheld rents to make necessary repairs except through the tenant's "repair-and-deduct" option, and there is no provision for appointment of a receiver authorized to make necessary repairs.<sup>150</sup>

4. *Common Law Implied Warranty of Habitability*.<sup>151</sup> At least ten jurisdictions have held that in every residential letting the landlord impliedly warrants that the premises are habitable.<sup>152</sup> The obligation is held to be breached whenever there are housing code violations that have a substantial adverse effect on the health or safety of the occupants.<sup>153</sup> In some states, it is apparently not necessary that there be code violations; it is sufficient if the condition is such as to be a serious threat to health and safety.<sup>154</sup> Most courts say that the implied warranty includes a continuing obligation to keep the premises habitable after the original letting, except, of course, for problems created by the deliberate or negligent conduct of the tenant.<sup>155</sup> Remedies similar to those outlined in the discussion of URLTA have been used by the courts: viz. termination of the tenancy by leaving the premises, restitution of advance

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149. UNIFORM RESIDENTIAL LANDLORD AND TENANT ACT § 2.104.

150. Cunningham, *supra* note 142, at 69-70 (footnotes omitted).

151. *Id.* at 74-80.

152. *Id.* at 75.

153. *Id.* at 83-86.

154. *Id.*

155. *Id.* at 86-95.



payments, damages in reduction of rental liability, repair and deduct, and rent withholding and abatement while continuing in possession.<sup>156</sup>

## 2. *Policy Analysis of Implied Warranty of Habitability*

### a. *Economic Efficiency*

As a matter of efficiency, the economist would argue that repairs and maintenance should be done only if they increase the fair market value of the premises more than they cost. Thus, if repairs cost \$500 but they increase (or prevent the decrease of) the value of the property by \$1,000, the repairs are "efficient." In such case, the tenant would not need a legal right to the repairs because presumably the landlord would perform them anyway. Suppose, on the other hand, that the costs were not worth the benefits derived, for example that a \$1,000 repair would increase market value only \$250. In that situation, giving the tenant the right to the repairs, enforceable by specific performance or damages, would raise the landlord's costs. The landlord would then (along with all other landlords) seek to raise rents or get an agreement waiving the right. Since the increase in value of the property is by hypothesis less than the increase in rent, it is likely the tenant would choose not to pay the additional amount but rather to waive his right to the repairs, on the theory that the amount fair market value goes up is a reasonable measure of the repairs' utility, and they would not be worth the rental increase to the tenant. Thus, it would appear that the efficient result of no repair would occur no matter whether the law required the landlord to repair or not. In summary, economic analysis would indicate that an efficient repair will take place whether there is an implied warranty of habitability or not, and that an inefficient one will be waived by a tenant who would prefer lower rents to repairs that are not worth their costs.

But suppose the law were that the tenant had an unwaivable<sup>157</sup> right to require the landlord to repair. This is the law in a number of states.<sup>158</sup> Again the efficient repairs would be made. The case of inefficient repairs is a bit more complex. There, the landlord would make the repairs and attempt to raise rents, assuming that he perceived that the tenant was willing, if necessary, to expend the energy and costs required to obtain specific performance from him. But if specific performance were not available and the tenant's only remedy for breach were damages in the form of rent abate-

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156. *Id.* at 98-126.

157. This is what Calabresi calls inalienability. See Calabresi & Melamed, *supra* note 135.

158. Cunningham, *supra* note 142, at 95-98.

ment, the landlord would have to decide whether the cost of making the repairs was less than the probable rent reduction, and then choose the cheaper alternative. In a particular case this might induce an inefficient repair, *i.e.*, one whose cost did not yield a commensurate increase in property value. This would occur where the cost of the repair was less than the projected abatement of rent. On the other hand, it is quite possible that where the landlord chose not to make the repair, net rents might end up the same as if there were no implied covenant. That is, assuming there were no rent controls, such a landlord would attempt to raise rents in anticipation of his corresponding liability for rent abatement. In summary, the economist would argue that giving the tenant an unwaivable warranty of habitability would be either ineffective or result in inefficient repairs if damages were the remedy, and result in inefficient repairs if specific performance were.

*b. Fairness*

One could argue that the new imposition of a warranty of habitability would not be unfair to a landlord, so long as rents were not controlled and he could recoup his higher costs by charging higher rents. But more importantly, many feel as a matter of basic fairness to tenants that they should have a right, enforceable by law, to expect and require a habitable dwelling. In answer, it has been said that when they rent dwellings tenants generally know what they are getting and are agreeing to pay a particular rent in the light of those conditions. But that really is not a sufficient reply, for it is clear that most tenants renting substandard housing are not in a strong position to bargain for better housing or lower rents. So the fairness argument remains a compelling one, and it undoubtedly accounts for the great metamorphosis in the law that the implied warranty of habitability represents.

Unfortunately, however, the fact that legislatures and courts have the best of intentions and make laws whose purpose is to improve the conditions under which people live does not necessarily mean that their goal will be achieved. Anyone who is alive and observes the slum conditions of the large cities can tell you that the new rules of law are still having minimal or no effect on the serious problems of housing in this country. There have been a number of empirical studies,<sup>159</sup> some indicating that the laws are

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159. Abbott, *Housing Policy, Housing Codes and Tenant Remedies: An Integration*, 56 B.U.L. REV. 1, 62-64, 139-46 (1976); Heskin, *The Warranty of Habitability Debate: A California Case Study*, 66 CALIF. L. REV. 37 (1978); Hirsch, Hirsch & Margolis, *Regression Analysis of the Effects of Habitability Laws Upon Rent: An Empirical Observation on the Ackerman-Komesar Debate*, 63 CALIF. L. REV. 1098, 1116-36 (1975); Krumholz, *Rent Withholding as an Aid to*

essentially ineffective and some indicating that some repairs are induced by enforcement. But even where improvement is noted, account must be taken of the fact that only a small proportion of people living in substandard dwellings are availing themselves of the law. No one has observed that substantial across-the-board improvements in living conditions have occurred as a result of changes in the law. That is not to say that the implied warranty is completely worthless. As a hortatory expression of national purpose it may have some value. But none should be under the illusion that we will really solve housing problems by common-law measures. And economic analysis should give us some pause about whether undisclaimable warranties might not do more harm than good if uneconomic repairs are induced.

#### IV. CONCLUSION

Certainly if it was fair to say that the old law had a bias in favor of landlords, it is equally fair to say that the new law has the opposite orientation. Those who have said that landlords are regulated much as public utilities are, certainly have a point. Rent control, anti-condominium conversion laws, and regulation of quality of housing all are evidence of that. But labelling the regulations in that fashion does not begin to answer the question of whether they tend to reach toward the goals of fairness and efficiency.

From the standpoint of fundamental fairness, these regulations probably are acceptable so long as rents can be raised to accommodate newly created rights. And even rent control itself would in the long run pass a fairness test as investors discount its effect in the price they pay for rental property. But the short-run effect of

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*Housing Code Enforcement*, 25 J. HOUSING 242 (1969); Mosier & Soble, *Modern Legislation, Metropolitan Court, Miniscule Results: A Study of Detroit's Landlord-Tenant Court*, 7 U. MICH. J.L. REF. 8 (1973); Rose & Scott, "Street Talk" Summons in Detroit's Landlord-Tenant Court: A Small Step Forward for Urban Tenants, 52 J. URB. L. 967 (1975); Note, *The Great Green Hope: The Implied Warranty of Habitability in Practice*, 28 STAN. L. REV. 729 (1976); Comment, *The Pennsylvania Project—A Practical Analysis of the Pennsylvania Rent Withholding Act*, 17 VILL. L. REV. 821, 860-85 (1972).

The Abbott study of Boston did indicate that rent abatement was probably effective where raised as a defense and might trigger some repair. However Mosier and Soble's, as well as Rose and Scott's study of Detroit indicated the change in law had very little effect in tenancy actions. The Sanford study indicated similar results in San Francisco. On the other hand, the Heskin study of Southern California found that where complaints were made to legal services' lawyers, repairs were made in 80% of the cases.

The point that must be recognized with respect to those studies indicating some increase in repair as a result of habitability laws is that the vast majority of tenants never seek any legal recourse, and substantial change in their living conditions is not occurring. =

rent control is grossly unfair to landlords who had no expectation of its passage and paid a price accordingly.

The regulations badly fail on efficiency grounds. Rent control in the long run will lead to less rental housing construction, more abandonments of existing marginal housing, and may induce the otherwise uneconomic sale of better housing to owner-occupants. Stringent anti-condominium conversion laws will frustrate efficiency by preventing in some cases a rational reallocation of resources to their more valuable uses. Habitability laws might cause inefficient repairs to be made where the tenants' rights are unwaivable.

Taken together, the rules represent an attempt by government to insure that there will be available a large supply of habitable rental housing at affordable costs to tenantry. To a great extent the laws are self-defeating. It is likely that as a result of them there will be less rental housing and that certainly means higher rents. What this probably portends for the long run is more state intervention in the housing market. Government may offer more subsidies or it may well become the major rental housing supplier of last resort. For those of us who regard government ownership and management of enterprise a horror, this is indeed a depressing prospect.