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APPROVAL OF THE APPELLATE DIVISION

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-0757-07T1

MOSHE Z. SCHAPIRO,

Plaintiff-Respondent/
Cross-Appellant,

v.

MICHAEL SU a/k/a MICHAEL WEN-SU
and DIANA STOYANOVA-SU a/k/a
DIANA MINTCHEVA STOYANOVA-SU,

Defendants-Appellants/
Cross-Respondents.

Submitted October 16, 2008 - Decided May 29, 2009

Before Judges Stern, Payne and Waugh.

On appeal from Superior Court of New Jersey,
Chancery Division, Hudson County, Docket No. C-3-06.

Frank P. Marciano, attorney for appellants/
cross-respondents.

Robert M. Mayerovic, attorney for respondent/
cross-appellant.

PER CURIAM

Defendants, owners of a residential three-family apartment building in Hoboken, appeal from a judgment entered on August 28, 2007, which granted plaintiff's "request for reformation of contract" and set the contract price at $870,000, permitted plaintiff to "waive the entitlement to purchase the

property at the reformed price," and set a date for the election. On this appeal, defendants argue that "there was no mutual mistake ... and ... no unilateral mistake on the part of plaintiff with unconscionable conduct on the part of defendant that justifies reformation of the contract" and "there is no justification for specific performance of the contract." On the cross-appeal, plaintiff seeks an additional reduction of $153,429 from the sale price as the new landlord will be responsible to tenants and former tenants for "rent over charges."

Defendants Michael Su and his former wife[1] purchased a three-family building at 110 Park Avenue in Hoboken on February 20, 2004, at a price of $825,000. Prior to the purchase, defendant received rent registration forms from the previous owner showing the rents for the apartments within the building from the years 1994, 1999, and 2003. He never checked the legality of the rent charged, including the base rents of $1,550 and $1,900 for the smaller two apartments As a result, he never made "any inquiry to determine whether the rents were legal" for the two smaller units he intended to rent, and he accepted the "represented base" rents to be $1,550 and $1,900.

[1] Hereafter we refer to defendant Michael Su as the "defendant."

Defendants intended to live in the largest unit and rent the other two, then vacant, units.

After his purchase of the building, in January of 2005, defendant filed a rent registration form for the property with the City of Hoboken Rent Control Office, stating rents of $2,448 and $2,637 for the two smaller apartments, indicating an increase due to "vacancy decontrol." At the bottom of the rent registration form defendant filed, similar to the ones he received during his purchase of the building, were the words: "IMPORTANT: THE FILING OF THE RENT REGISTRATION DOES NOT CONSTITUTE A DETERMINATION BY THE RENT LEVELING OFFICE AS TO THE LEGALITY OF THE RENT SET FORTH IN THIS STATEMENT."

Incident to their separation and divorce, defendant and his wife subsequently placed the building on the market for sale. In July 2005, defendant listed the property, indicating monthly rents for the two apartments at $1,550 and $1,900 and stating the property provided "good income." Prior to signing the listing agreement, defendant again neglected to verify that the rents for the rental units were "legal rents." In the property settlement agreement with his wife, defendant agreed to pay her $103,000 from the sale of the property, regardless of the sales price.

Defendant and his wife set the initial asking price for the building at $1,400,000 based upon their review of other properties in Hoboken. In October 2005, plaintiff offered to purchase the building for $1,205,000. Plaintiff's attorney prepared a contract for the sale, which defendants' attorney reviewed and approved with some modifications submitted in a rider sent with a letter dated October 12, 2005. Plaintiff's attorney responded on October 17, generally agreeing to the contents of the rider, but listing a few other items plaintiff wished to incorporate into the agreement, including "a certification from the rent control office that the rents being charged to the two tenants are in fact legal rents," and a representation by defendant that the tenants were not "entitled to any post closing credits and adjustments of rents." In response, defendant certified the tenants would not be entitled to post closing credits. He also indicated in an email that he was in the process of obtaining the legally registered rents from the Hoboken Rent Control Office.

On October 21, 2005, defendant received a certification from the Hoboken Rent Control Office that the legal rent for the duplex unit in the property in which he lived had a legal rent of $2,186. However, the legal rents for the other two apartments were not listed.

Plaintiff accepted defendant's rider to the contract, executing it on October 24 and returning the executed rider together with a deposit check of $25,000 on October 28, 2005. On October 31, defendant sent a second request to the Hoboken Rent Control Office, requesting updated legal rents for the other two apartments.

When the Hoboken Rent Control Office received defendant's second request, it determined the legal rents for the two apartments would be much lower than the registered rents on file. The Rent Control Office contacted defendant regarding this fact by phone, and he elected not to receive the determination in writing, stating he wished to talk with his attorney first. Defendant's attorney told him to wait until they knew how to proceed before requesting the certification of legal rents for the two apartments.[2]

At some point between the end of October and early December, defendant disclosed the problem with the rental amounts. On December 15, 2005, defendant's attorney sent plaintiff's attorney a letter discussing the inability of the parties to reach an agreement regarding how to proceed because

[2] As will be hereinafter noted, the Board's practice was to ask landlords if they desired certifications of "legal rent" when the "legal rent" was less than that submitted on the filing.

the rents being charged to the two tenants were not "legal rents."

Among the points in the letter was a statement regarding the likely range of the actual legal rents for the apartments, that defendant had been willing to give plaintiff a $25,000 credit against the purchase price due to the discrepancy, and that plaintiff had counter offered with a requested "discount" of $200,000 to $250,000. The letter from defendant's counsel to plaintiff's attorney read:

> Please be advised that I have sent to you simultaneously with this letter a formal Time of Essence letter for this closing. I make the following comments in support of my client's decision to cancel this contract if your client does not complete the transaction by January 6, 2005.
>
> 1. My client has always conditioned his statement of rents on the receipt of the official rent calculations from the Hoboken Rent Control officer. I am attaching a letter from my client to the Rent Control office which has [sic] sent on November 7, 2005. This letter confirms my client's efforts to obtain the Certified Rents from the City of Hoboken.
>
> 2. When my client bought the building, he was given a Rent Registration Statement from the seller which my client believed was the actual legal rent (a copy of which is attached hereto).

3. After the rent control office received my client's letter, they verbally told Mr. Su that the actual legal rent on the units was for less than that on the statements, as little as $500-$600 dollars for the 2nd and 3rd floor units. This is an owner occupied building with 2 rental residential units or less and is not subject to N.J.S.A. 2A:18-53.1 et seq. and tenants are only protected in their leasehold to the extent of any written lease with the landlord.

4. Based upon the current condominium market, if this building was broken out to 3 condos, it could easily sell for an amount in excess of $1.5 million.

5. Even though the value of the building is not directly affected by the registered rents, my client was willing to give your client a credit in the amount of $25,000 because of the discrepancy in what my client thought were the legal rents and what the actual legal rents are.

6. Your client counter offered for a discount on the purchase price in the amount of $200,000-$250,000. At this time, if your client is not going to pay the purchase price of this property (less the $25,000 credit offer) and indemnify my client against any lawsuit filed by any tenants against him, then your client is in default of the contract and subject to a suit for damages. However, under the circumstances,

> my client will not seek any damages from your client.

On the same day, defendant's attorney also sent plaintiff's counsel a formal "time of the essence" letter setting the closing at 1:00 p.m. on January 6, 2005. That notice provided in part:

> TAKE FURTHER NOTICE, that unless you and your attorney attend at the time and place set for closing, and are prepared to give title to said premises in accordance with the foregoing contract of sale, we shall hold you liable for any and all damages sustained as a result of your failure to perform said contract.

plaintiff did not appear at the closing, but instead filed suit seeking specific performance, reformation of the sales price, compensatory damages, and punitive damages for fraudulent conduct. Among other things, plaintiff alleged that "Defendants represented to the Plaintiff that the sale was conditioned upon legally registered rents and that the rents represented were lawful rents." Plaintiff further alleged that he had "bargained for the purchase of a property with a specific rent roll."

Upon receipt of the complaint and summons, defendant's attorney sent plaintiff a letter "formally canceling [the] contract" based on plaintiff's failure to honor the contract term and the "time of the essence" letter. Defendant returned the $25,000 deposit with the letter, and indicated that both

parties were aware of the need for legal rents to be determined by the Rent Control Office, and that plaintiff's knowledge that they were too low was why he sought a credit of $200,000 to $250,000 on the purchase price instead of proceeding to closing. In the words of defendant's counsel "[s]ince we disclosed the fact that the legally calculated rents were less that the registered rents, we prevented your client from any possibility of damages."

On December 1, 2006, plaintiff's attorney received a calculation of the legal rents for the two rental apartments from the attorney for the Rent Control Office. The calculation found the "proper base" rents to be $321 and $345.

During trial, Carol McLaughlin, Hoboken's Director of Rent Control, testified to the process regarding inquiries made to her office to ascertain legal rents. She also testified that there was no "legal obligation" on the part of a building owner to find the legal rents before selling a property, but that the buyer often requests them. She also testified that it was not unusual for a landlord to not proceed with a formal "calculation" of the legal rents when they are told they are actually lower than what the landlord is currently charging.

When a tenant requests a calculation of the rents for a property, the Rent Control Office provides it because the

governing ordinance provides the tenant "has a right to the calculation." The tenant has "the right to a credit or a refund" for all the overcharges of rent, although the Rent Control Office does not enforce that or become involved in the reimbursement of overcharges. According to Ms. McLaughlin, tenants are even entitled to "refunds" for overcharges of rent after they have "moved out" of an apartment, going back for the entire period they were being overcharged.

Plaintiff also produced expert testimony by a real estate appraiser, Carl Mucciolo, who had been retained to determine an accurate value for the property. In his testimony, Mucciolo stated that he first looked at the contract price, which he assumed was a negotiated price between the parties. He then examined several other recently sold properties in Hoboken that were comparable to defendant's building to determine the impact of rental income on the purchase price of the properties.

In considering the comparable properties, Mucciolo looked at three potential ratios to determine which would have the most effect on the value of each property: "value per square foot, value per unit, and value per gross rent multiplier," and determined that the "gross rent multiplier" produced the "closest, tightest range of value" for determining the comparable sales. He took the represented rents and the

contract sales price and came up with "a gross rent multiplier of 166," which was "comfortably within the range of the other [comparable] sales." However, considering the legal rents for the apartments, Mucciolo found the gross rent multiplier jumped up to 427 when compared with the contract price "which is well far outside the range" in the comparison properties, from which he concluded that the rental data had an impact on the price a buyer was willing to pay.

Mucciolo then proceeded to describe how he set out to determine a correct market value for the property, noting that the real estate market in Hoboken had unique considerations and that the condominium market has a very significant impact on prices. He stated that based solely on the gross rent multiplier, the defendant's property would only be worth about $500,000, which he indicated would be a "silly conclusion" in Hoboken. Thus, he discounted the effect the gross rent multiplier had on the value of the property and looked at the value of the property should it be converted to condominiums, which he concluded was the "highest best use of the property." In doing this Mucciolo looked at the value per unit of the comparable property and value per square foot for each, making an average of those ratios plus the discounted gross rent multiplier, and reached a value of $870,000 for the building

"based upon legal rents." On cross examination, Mucciolo was asked why plaintiff was willing to pay a purchase price of $1,205,000 in 2005 when defendant had bought the property only a year earlier for $825,000. Mucciolo admitted he could not answer the question, as a purchase price is "a market value number," and "[m]arket value by definition is a value in exchange," whereas plaintiff might have been willing to pay more for the property due to its location. In any event, Mucciolo found that "in the marketplace that $1,205,000 was well beyond the highest end of the value range," independent of "the income stream" reported by defendant to plaintiff.

Defendant produced no expert testimony.

In his oral opinion of August 14, 2007, the judge determined there was an "inference that the representation of the rents by the defendant to the plaintiff was a significant factor in the plaintiff's agreeing to enter into this contract." He also determined that there was "a mutual mistake" regarding the value of the property based on the represented rents, but that defendant committed no fraud as he may have been told by "prior counsel that the rents he was charging were legal." However, defendant had acted inequitably by choosing not to have the legal rent calculations put in writing when he learned they were low and by trying to force plaintiff to close when

plaintiff was not willing to do so based on the misrepresented rents. The trial judge also concluded that plaintiff "has done nothing wrong."

In sum, the judge reformed the contract price and concluded:

> The issue is what does the Court believe or how does the Court view Mr. Su's conduct. At best for Mr. Su, he was mistaken based upon perhaps some prior legal advice. Under the — under a worse scenario, he committed fraud by trying to hide the true rents that would be — that could be charged under the Hoboken Rent Control Ordinance.
>
> So whether it be mutual mistake or mutual mistake accompanied by inequitable conduct, I'm satisfied that reformation of this contract is appropriate.
>
> . . . .
>
> I'm not forcing the plaintiff to purchase the property. He has the option to purchase the property at $870,000. He must notify the defendant by August — on or before August 31st.
>
> If he chooses to purchase the property then the contract sales price is $870,000.

We modify that judgment. The contract made no representation regarding the legal rent of the residential units, and plaintiff did not testify at trial, so the record embodies no indication of his actual desire to lease the apartments for profit or that the lawful rental price was material to the purchase price. However, plaintiff asked

defendant to supply a certification from the Rent Control Board as to the legal rent, and the addendum to the contract required same.

Clearly, plaintiff's interests were protected by his attorney, and defendant's conduct in not requesting the Board to generate the written certification when he learned the "legal rents," could not alter what the agreement required. As the trial judge did not find that defendant committed fraud, and the contract addendum protected plaintiff with respect to securing a certification of the Rent Control Office concerning "legal rents," we cannot conclude there was a basis for permitting plaintiff to both reform the purchase price and elect whether or not to perform. Stated differently, we cannot uphold the judge's determination as to reformation of the contract price.

Reformation of a contract is an equitable remedy, traditionally available when there exists "either mutual mistake or unilateral mistake by one party and fraud or unconscionable conduct by the other." Dugan Constr. Co. v. N.J. Tpk. Auth., 398 N.J. Super. 229, 242-43 (App. Div.), certif. denied, 196 N.J. 346 (2008) (quoting St. Pius X House of Retreats, Salvatorian Fathers v. Diocese of Camden, 88 N.J. 571, 577 (1982)). Courts view reformation as an "extraordinary remedy," requiring "[c]lear, convincing proof of facts pertinent to the

remedy." Martinez v. John Hancock Mutual Life Ins. Co., 145 N.J. Super. 301, 312 (App. Div. 1976), certif. denied, 74 N.J. 253 (1977) (citing Heak v. Atlantic Cas. Ins. Co., 15 N.J. 475, 481 (1954)); see also, Toth v. Vazquez, 8 N.J. Super. 289, 293-94 (App. Div. 1950), certif. denied, 7 N.J. 76 (1951).

Our Supreme Court has stated that mutual mistake exists only when "both parties were laboring under the same misapprehension as to [a] particular, essential fact." Bonnco Petrol, Inc. v. Epstein, 115 N.J. 599, 608 (1989) (quoting Beachcomber Coins, Inc. v. Boskett, 166 N.J. Super. 442, 446 (App. Div. 1979)). Additionally, "New Jersey law also requires for reformation for mutual mistake that the minds of the parties have met and reached a prior existing agreement, which the written document fails to express." Bonnco, supra, 115 N.J. at 608 (citing St. Pius X, supra, 88 N.J. at 579).

Where there is no mutual mistake, reformation of a contract may be granted only when the facts of the case give rise to equitable fraud. Id. at 609. Our Supreme Court set out the means of distinguishing equitable fraud from legal fraud as follows:

> A misrepresentation amounting to actual legal fraud consists of a material representation of a presently existing or past fact, made with knowledge of its falsity and with the intention that the other party rely thereon, resulting in

> reliance by that party to his detriment. The elements of scienter, that is, knowledge of the falsity and an intention to obtain an undue advantage therefrom, are not essential if plaintiff seeks to prove that a misrepresentation constituted only equitable fraud. Thus "[w]hatever would be fraudulent at law will be so in equity; but the equitable doctrine goes further and includes instances of fraudulent misrepresentations which do not exist in the law." Consequently, where ... a party seeks only equitable remedies, he or she need meet only the lesser burden; it is not necessary to show scienter. Id. (internal citations omitted).

See also Jewish Center of Sussex County v. Whale, 86 N.J. 619, 624-25 (1981); Daibo v. Kirsch, 316 N.J. Super. 580, 588 (App. Div. 1988) ("a party claiming equitable fraud must prove the required elements by clear and convincing evidence").

In a situation where reformation is appropriate, its purpose "is to restore the parties to the status quo ante and prevent the party who is responsible for the misrepresentations from gaining a benefit." Bonnco, supra, 115 N.J. at 612 (citing Enright v. Lubow, 202 N.J. Super. 58, 72 (App. Div. 1985)). Here, the trial judge did not specifically find, by the required clear and convincing evidence, that there was either mutual mistake as to the "legal rent" or unilateral mistake by the plaintiff and inequitable conduct by the defendant. To the extent his opinion could be so read, the record does not warrant a finding, by clear and convincing evidence, that plaintiff

entered the agreement as a result of defendant's representation of the "lawful rent;" nor did defendant make representations designed to have plaintiff rely on a misstatement of the "lawful rent" either before or after he learned them. To the contrary, the plaintiff's attorney required that defendant obtain the certification of legal rent. There was no reliance by plaintiff on defendant's representation. We therefore need not develop the impact of the advice defendant received from his attorney not to request the certification in writing or of the letter his attorney wrote to plaintiff's counsel about the incorrect figures.

Moreover, in his testimony, plaintiff's expert stated his final calculations of the market value of the building considered pricing the property based on converting it into condominiums, which he felt was "the highest and best use of the property." (Defendant's attorney so noted in one of his December 15, 2005 letters.) The expert also admitted on cross examination that there could be other factors that could affect the price a buyer is willing to pay, and that only the plaintiff could answer whether there were any in this case. As plaintiff did not testify, we cannot say, even if the rental rates were misrepresented by defendant, that the plaintiff viewed the rental income of the property as a substantial basis for the

price. In any event, the lack of reasonable reliance on the figures by plaintiff is dispositive of the assertions of a mutual mistake or fraud by defendant.

Thus, reformation is not a viable remedy. See Bonnco Petrol, Inc. v. Epstein, supra, 115 N.J. at 608-09, 611-12. In Bonnco, the parties had contracted for the sale of property owned by the defendants, and after the parties negotiated the transaction, the plaintiff's attorney drafted the contract for the sale based on prior versions of the contract. 115 N.J. at 602-04. Included in the contract was an option agreement with a provision that the purchase price of the option would be counted as a credit against the sales price of the property, a term the plaintiff had believed defendants had agreed to during the negotiations. Id. at 603. When plaintiff's attorney presented the sales contract to the defendants, no mention was made of the addition of the credit provision to the option agreement. Id. at 604. Defendants skimmed the contract in the attorney's presence, and then signed it. Id. The Supreme Court found that this constituted equitable fraud regarding a material fact because "he has a right to rely upon the representation that [the contract] will be drawn accurately ... in accordance with [their] oral understanding." Id. at 611 (quoting Jewish Center, supra, 86 N.J. at 626 n.1). Furthermore, the Court stated:

> The object of equitable remedies such as reformation and rescission is to restore the parties to the status quo ante and prevent the party who is responsible for the misrepresentation from gaining a benefit. Enright v. Lubow, supra, 202 N.J. Super. at 72 (citing W. Keeton, D. Dobbs, R. Keeton, D. Owen, Prosser & Keeton on The Law of Torts § 105, 729 (5 ed. 1984)). In this case Bonnco is the party responsible for the misrepresentation. Hence, we find the equitable polices are best served by rescinding rather than reforming the real estate sales agreement between the parties. We do, however, agree with the Appellate Division majority that the $10,000 Bonnco paid for the option should be returned as part of the rescission remedy.
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> [Id. at 612 (emphasis added).]

See also id. at 614 (rescission remedy for equitable fraud); Diabo v. Kirsch, supra, 316 N.J. Super. at 591-92 ("money damages cannot be awarded for an equitable fraud").

Defendant here chose not to have the Rent Control Office calculate the legal rents after being orally told they were much lower than he had been charging. However, there is no indication he tried to hide this fact. Quite the opposite, the letter from defendant's attorney to plaintiff's attorney on December 15, 2005, shows that defendant had revealed the overpayments and both parties had tried to negotiate a modification of the purchase price in light of that new information. Accordingly, rescission (not reformation) was the appropriate remedy, and plaintiff can elect to rescind or honor

the contract. Merchs. Indem. Corp. v. Eggleston, 37 N.J. 114, 130-31 (1962); Diabo v. Kirsch, supra, 316 N.J. Super. at 591-92.[3]

The record supports the trial judge's conclusion that defendant breached the contract when he did not produce a certification of the Hoboken Rent Control Board "that the rents being charged to the two tenants are in fact legal rents." As a result, the Chancery Division, as a matter of equity, could give plaintiff the option to close the purchase at the contract price minus the $25,000 reduction offered or to rescind the contract. See Marioni v. 94 Broadway, Inc., 374 N.J. Super. 588, 599-600 (App. Div.), certif. denied, 183 N.J. 591 (2005). See also Restatement (Second) Contracts § 357 ("specific performance of a contact duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of duty").

Accordingly, we reverse the judgment granting plaintiff the right to close at the reformed price. Of course, in exercising his rights plaintiff may consider any potential liability the landlord may have to former tenants under the Rent Leveling Ordinance.

[3] Plaintiff does not seek specific performance at the contract price.

The judgment is reversed as to the reformation, and the matter is remanded for further proceedings consistent with this opinion.