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The Post-'Roberts' World Is (Somewhat) Clarified

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As many have observed, the Court of Appeals' 2009 decision in *Roberts v. Tishman Speyer Props., L.P.*[1] left many questions unanswered as to how erroneously deregulated apartments in J-51 buildings should be returned to the rent stabilization fold. One question was how to compute stabilization rents for those apartments, many of which had been renting at market rates for years. Another question was whether luxury deregulation would again be available to owners once J-51 benefits expired.

In two recent decisions, *72A Realty Assocs. v. Lucas*[2] and *Schiffren v. Lawlor*,[3] the Appellate Division, First Department addressed these issues.

'Lucas'

In our Sept. 5, 2012 column, we observed that the issue of how rents were to be calculated for erroneously luxury deregulated apartments had seemingly been settled by the Appellate Term, First Department's decision in *72A Realty Assocs. v. Lucas*, 32 Misc.3d 47, 929 N.Y.S.2d 349 (App. T. 1st Dept. 2011), aff'g 28 Misc.3d 585, 902 N.Y.S.2d 791 (N.Y.C. Civ. Ct. 2010). The column, entitled "Appellate Term Governs J-51 Calculations (For Now)," noted that leave to appeal had been granted in *Lucas* , such that the Appellate Division was expected to rule in the Fall. The Appellate Division has now ruled, and Appellate Term's rent calculation methodology—which was highly favorable to landlords—is no more.

After *Roberts*, tenant advocates argued that the rents of erroneously luxury deregulated apartments should be calculated in a draconian fashion, denying owners rent increases to which they would otherwise be entitled, such as statutory vacancy increases, standard Rent Guidelines Board renewal increases, and individual apartment increases. Owners, conversely, argued that they should not be unduly penalized for following DHCR's erroneous interpretation of the luxury deregulation provisions of the Rent Stabilization Law, and should be entitled to all standard rent increases, without exception. In particular, owners argued that treble damages should not apply in post- *Roberts* J-51 overcharge cases, because owners had followed DHCR's advice in good faith.

The issue was met straight on in Civil Court's May 25, 2010 decision in *Lucas* . There, the tenant took possession of an improperly deregulated apartment on Sept. 1, 2002, paying a rent in excess of $2,000 per month. In response to the owner's September 2008 holdover proceeding, the tenant alleged rent overcharge. Setting the rent, Judge Peter M. Wendt wrote as follows:

…respondent's counterclaim based on rent overcharge cannot exceed the four year period before it was interposed in October 2008. Thus, the base date rent for this purpose is the rent in effect in October 2004, in the amount of $2250 per month, pursuant to the lease between the parties commencing September 1, 2004. Also, since the landlord herein committed no fraud or conscious evasion of the RSL, respondent is not entitled to an award of treble damages.

Thus, in *Lucas* , the Civil Court, using the four-year statute of limitations, established the stabilized base date rent at the market rate of $2,250 per month that the tenant had been paying on the date four years before she alleged a rent overcharge.

On June 1, 2011, Appellate Term unanimously affirmed, holding:

With respect to tenant's rent overcharge counterclaim, we agree that no basis was shown for the court to go outside the four-year look-back period, tenant having failed to demonstrate a tenable claim of fraud or willfulness on the landlord's part. Nor has tenant shown any basis for application of the *Thornton* rent formula to determine the legal rent for the apartment (internal citations omitted).

The First Department, ruling on Dec. 4, 2012, rejected Appellate Term's methodology, stating:

The courts below, however, erred in setting the base date rent for the overcharge counterclaim at the $2,250 per month rate based on the market rate in the lease effective for October 2004. While that date is correct under CPLR 213-a, in light of the improper deregulation of the apartment and given that the record does not clearly establish the validity of the rent increase that brought the rent-stabilized amount above $2,000, the free market lease amount should not be adopted, and the matter must be remanded for further review of any available record of rental history necessary to set the proper base date rent.

The Appellate Division appears to have ruled that, contrary to Appellate Term's methodology, an erroneous "market" rent will not be the rent stabilized rent simply because it was the rent in effect four years before the tenant alleged rent overcharge. Instead, the court stated that "the matter must be remanded for further review of any available record of rental history necessary to set the proper base date rent." That would seem to include available rent records prior to the four-year look-back period. What happens if rent records are unavailable is unstated.

The Appellate Division also ruled:

The courts also erred to the extent they dismissed, as a matter of law, tenant's counterclaim seeking treble damages. Landlord, in its affidavit, states that in 2001, $30,000 worth of renovations to the apartment were completed, bringing the monthly rent above the $2,000 threshold. However, the record does not contain anything to support Landlord's renovation claim, including for example, bills from a contractor, an agreement or contract for work in the apartment, or records of payments for the renovations. A $1,491 monthly increase in rent is a substantial amount, and landlord did not further provide sufficient information to validate the increase. Further inquiry upon remand is required to determine whether the overcharge was not willful, but rather the result of reasonable reliance on the DHCR regulation.

The Appellate Division thus rejected Appellate Term's contention that treble damages should not be awarded in post-*Roberts* J-51 overcharge cases because landlords relied on DHCR's erroneous interpretation of the luxury deregulation provisions of the RSL. The Appellate Division ruled that, while reliance upon DHCR's interpretation is legitimate proof of good faith, the owner must nevertheless affirmatively make that case; it cannot simply be presumed.

'Schiffren'

In various post- *Roberts* cases, tenant advocates had argued that the receipt of J-51 benefits in a rent stabilized building permanently barred apartments therein from being luxury deregulated; i.e., luxury deregulation was unavailable even after J-51 benefits expired. In *Schiffren v. Lawlor*, the Appellate Division ruled that once J-51 benefits expire, luxury deregulation is again available, at least in certain types of buildings.

Before discussing *Schiffren*, some background is required. Under rent stabilization, there are two types of buildings that can receive J-51 benefits. First, there are those buildings—like the buildings in *Roberts* —that were subject to rent stabilization based on their pre-1974 construction date and thereafter received J-51 benefits (hereinafter "Type A" buildings). Second, there are those post-1973 buildings that were not stabilized at the time the owner received the J-51 benefits, but became stabilized solely by virtue of receiving such benefits ("Type B" buildings).

By 1985, dozens of apartments in Type B buildings were on the verge of becoming deregulated due to the expiration of J-51 benefits. In response, the Legislature added RSL §26-504(c) to the statute, which generally required owners of Type B buildings to provide tenants with a notice in their initial lease, and each renewal thereafter (the "J-51 Notice"), that J-51 benefits were due to expire on the stated date, and that the apartment would become deregulated upon the expiration of the lease in effect on that date.

In *Schiffren*, the tenant moved into a rent stabilized apartment in 1989. The building, a Type A building, began receiving J-51 benefits on July 1, 1995. Those benefits expired on June 30, 2006.

In 2008, two years after the J-51 benefits expired, the landlord sought to luxury deregulate the apartment based on high income. DHCR ruled that luxury deregulation indeed applied. In the subsequent Article 78 proceeding,[4] New York County Supreme Court Justice Paul Wooten affirmed DHCR's order. Specifically, the Supreme Court adopted DHCR's view that RSL 26-504(c) created Type A and Type B apartments. The Supreme Court held that pursuant to RSL 26-504 (c), luxury deregulation was not available for Type B apartments, and that such apartments would remain stabilized until the J-51 benefits expired, provided that (1) the apartment became vacant, or (2) the tenant had been supplied with the J-51 Notice mandated by the RSL. As to Type A apartments, Wooten ruled that no J-51 Notice was required:

Further the notice is required to state 'that the unit shall become subject to deregulation upon the expiration of such tax benefit period' (RSL §26-504[c]), which statement would be false if the unit was rent stabilized prior to the receipt of J-51 benefits.

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The Court therefore finds that, pursuant to RSL §26-504(c), petitioner's apartment unit was not granted permanent rent stabilized status until vacancy, and that the apartment unit is subject to luxury deregulation even though no §26-504(c) notice appeared in the petitioner's lease renewal.

In the subsequent appeal, the Appellate Division plainly stated the issue before it:

The issue raised on this appeal is whether, as a matter of law, a dwelling unit that was subject to rent regulation before an owner received J-51 tax benefits can be subject to luxury deregulation once those benefits expire.

The Appellate Division affirmed Supreme Court's ruling, stating:

The plain language of Administrative Code §§11-243 and 26-504(c) supports the conclusion that the Legislature intended to provide that a building that is already regulated when it receives J-51 benefits will continue to be regulated under the original rent-regulation scheme when the tax benefits expire. We conclude that the reversion to pre-J-51-benefit rent-regulation status includes the right of an owner to seek luxury deregulation in appropriate cases.

The court then continued:

While there is a collateral issue regarding whether tenant vacatur or notice in the lease is necessary to trigger reversion of a dwelling unit to the original rent-regulation regime, petitioner does not advance, and we do not decide, this issue on appeal.

As noted earlier, the J-51 Notice only had to be served on tenants in Type B buildings. The purpose of requiring such notice was to protect tenants in occupancy of Type B buildings who were on the verge of being evicted once J-51 benefits expired. Tenants in occupancy of apartments in Type A buildings were not in danger of being ousted when J-51 benefits ran out, and thus had no need to receive the J-51 notice.

Indeed, serving the J-51 notice on tenants in Type A buildings would have been deceptive, as Wooten noted in *Schiffren* , because it was not the case that such tenants would lose their stabilization status once those benefits lapsed. Those tenants would only lose their status if they otherwise qualified for luxury deregulation.

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Endnotes:

1. 13 N.Y.2d 270, 890 N.Y.S.2d 388 (2009).

2. 2012 NY Slip Op 08241.

3. __ A.D.3d __, 955 N.Y.S.2d 44 (1st Dept. 2012).

4. 2011 WL 2323242 (Sup. Ct. N.Y. Co.).