'73 Warren': What Does the First Department Mean?

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In its June 14, 2012 decision in *73 Warren Street v. New York State Division of Housing and Community Renewal*,[1] the Appellate Division, First Department, may have stated, in dicta, that in a building that was stabilized before the receipt of J-51 benefits, an owner can only take advantage of luxury deregulation where (1) the J-51 benefits expire, and (2) the tenant in occupancy at the time the J-51 benefits expired (and who is the subject of the luxury deregulation proceeding) was served with a notice pursuant to RSC §2520.11(o) stating that upon the expiration of J-51 benefits, the apartment would no longer be rent stabilized.

If that is indeed what the First Department said—and it is not at all clear—the First Department appears to have acted contrary to its own precedent and contrary to the governing statute.

Two Types of Buildings

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 v. Tishman Speyer Props.*[2]—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 J-51 benefits, but became stabilized solely by virtue of receiving such benefits ("Type B" buildings).

In *Roberts*, the Court of Appeals held that luxury deregulation is not available in either Type A or Type B buildings while J-51 benefits are still being received.

L. 1985, Chapters 288 and 289

Before June 19, 1985, apartments in Type B buildings would automatically become destabilized when J-51 benefits expired. See *Bleecker Street Mgmt. v. New York State Division of Housing and Community Renewal*.[3] By mid-1985, thousands of stabilized apartments in Type B buildings were about to drop out of rent stabilization upon the expiration of J-51 benefits. In response, the Legislature enacted L. 1985, ch. 288 and 289 to amend, inter alia, RSL §26-504(c). As Senator Roy Goodman of Manhattan colorfully described the 1985 legislation:

Before I tell you what that purpose is, let me tell you that the mail in my office runs approximately twenty to one in favor of assuring that priority purpose is accomplished. And what is it? *Protect the tenants in place*, the people who are right now in the apartments who require protection, who are concerned beyond measure of description about being tossed out on their skinny rumpuses the moment that this bill expires (emphasis supplied).[4]

To protect those "skinny rumpuses," the Legislature amended RSL §26-504(c) to provide that rent stabilization shall apply to:

Dwelling units in a building or structure receiving [J-51] benefits…not owned as a cooperative or as a condominium, except as

provided in section three hundred fifty-two-eeee of the general business law and not subject to [rent control]. Upon expiration or termination for any reason of [J-51] benefits…any such dwelling unit shall be subject to [the RSL] until the occurrence of the first vacancy of such unit after such benefits are no longer being received *or if each lease and renewal thereof for such unit for the tenant in residence at the time of the expiration of the tax benefit period has included a notice in at least twelve point type informing such tenant that the unit shall become subject to deregulation upon the expiration of such tax benefit period and states the approximate date on which such tax benefit period is scheduled to expire*, such dwelling unit shall be deregulated as of the end of the tax benefit period; *provided, however, that if such dwelling unit would have been subject to this chapter or the emergency tenant protection act of nineteen seventy-four in the absence of this subdivision, such dwelling unit shall, upon the expiration of such benefits, continue to be subject to this chapter or the emergency tenant protection act of nineteen seventy-four to the same extent and in the same manner as if this subdivision had never applied thereto* (material in brackets and italics supplied).

Thus, in Type B buildings, stabilization would continue after the expiration of J-51 benefits (1) until the tenant vacated, or (2) sooner if the tenant's initial lease and each renewal lease thereafter contained a notice (the "J-51 Notice") stating that his or her stabilization status would end once J-51 benefits expired.

In 1987, DHCR promulgated RSC §2520.11(o) to implement the Legislature's 1985 amendment to RSL §26-504(c).

'73 Warren'

In *73 Warren*, the building at issue was a Type B building which became subject to stabilization solely by virtue of its receipt of J-51 benefits in 1977. Those benefits expired in 1990. In 2008, the owner, on the basis of high income deregulation pursuant to RSL §26-504.1, sought to luxury deregulate the apartment of Victor Schrager, a tenant since 1984. DHCR denied the luxury deregulation application, holding that luxury deregulation is not available in Type B buildings. Supreme Court affirmed, and was in turn affirmed by the First Department, which held that pursuant to RSL §26-504(c):

…an apartment that becomes rent stabilized upon the building owner's receipt of J-51 benefits [i.e., a Type B building] remains stabilized upon the expiration of those benefits, except in two distinct instances: where the stabilized tenant vacates, or where the stabilized tenant has been consistently and properly notified in his leases that the apartment would become deregulated upon the expiration of the tax benefits. The statute also provides that if the building was already regulated when the owner began to receive tax benefits [i.e., a Type A building], it continues to be regulated upon the expiration of the tax benefits under the statutory scheme that initially gave rise to regulation. Here, it is undisputed that because Schrager is still in possession and was not given the requisite notices, the apartment continued to be rent stabilized after the expiration of the J-51 benefits (material in brackets supplied).

In *73 Warren*, the owner argued that once J-51 benefits expire in a Type B building, RSL §26-504.1 (high income luxury deregulation) kicks in, such that the owner could now attempt to luxury deregulate the apartment based on high income. By so arguing, the owner relied on the language in §26-504(c) which states that when J-51 benefits expire in Type A buildings, the apartments therein "continue to be subject to this chapter or the emergency tenant protection act of nineteen seventy-four to the same extent and in the same manner as if this subdivision had never applied thereto." The First Department rejected the owner's argument in language that some practitioners have found confusing:

First, this Court was not construing Administrative Code §26 504(c) in *Roberts*. Rather, by quoting it, we were merely offering support for our point that 'the overall statutory scheme [of subjecting buildings receiving tax benefits to rent regulation]…makes no distinction based on whether a J-51 property was already subject to regulation prior to the receipt of such benefits' (id.). Further, and in any event, it is plain from the statute that the Legislature simply intended to provide that a building that is already regulated when it begins to receive J-51 benefits continues to be regulated for the original reason when the tax benefits expire *and an apartment is vacated or a non-vacating tenant received the notice described in this section. Presumably, under those circumstances the owner could resort to luxury decontrol*. However, here there was no vacatur or notice, so even if the building had been regulated before the receipt of tax benefits, that fact would be irrelevant (material in brackets in original, italics supplied).

By so holding, the court appeared to state that in Type A buildings, luxury deregulation will only attach upon the expiration of J-51 benefits if the tenant in question had received the J 51 Notice, i.e., the Notice stating that rent stabilization will terminate once J-51 benefits expire.

Such a ruling would be problematic. As noted earlier, the J-51 Notice only had to be served on tenants in Type B buildings. The point of requiring such notice (as mandated by the 1985 legislation and as codified in RSC §2520.11[o]), was to protect tenants in occupancy of Type B buildings who were on the verge of being evicted. Tenants in occupancy of apartments in Type A buildings were not in danger of being ousted when J-51 benefits expired, 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, in that it was *not* the case that such tenants would lose their stabilization status once those benefits lapsed.

In *Gersten v. 56 7th Avenue*,[5] the First Department appeared to hold that in Type A buildings, luxury deregulation could proceed where no J-51 Notice has been served. In *Gersten*, a tenant in a Type A building argued, inter alia, that an unappealed DHCR luxury deregulation order (issued pre-*Roberts*) should be belatedly annulled because DHCR purported to luxury deregulate the apartment while J-51 benefits were still in effect. In the course of its decision, the First Department observed that the J-51 Notice need only be served on tenants in Type B buildings:

Where the building only became subject to rent regulation due to its participation in the J-51 program, RSL [Administrative Code] §26-504(c) expressly provides that once the tax benefits terminate, the units may be deregulated in one of two ways. One way is for the owner to include a J-51 rider in the lease informing the occupant that the apartment will be deregulated upon the termination of the benefit (id.); Rent Stabilization Code (RSC) [9 NYCRRR §2520.11[o]]. If the lease does not contain the requisite notice, occupied units remain subject to rent stabilization until a vacancy occurs after the expiration of the J-51 benefits.

Owners of rent regulated buildings also frequently apply for and received J-51 benefits for such routine work as boiler installations, new windows, elevator upgrades and the like. The receipt of J-51 benefits under such circumstances have no effect on the building's rent-regulated status. That is, a rent stabilized building will be rent stabilized before, during and after the receipt of J-51 benefits (material in brackets in original, internal citations omitted).

The tenant in *Gersten* complained that DHCR's unappealed, albeit erroneous, luxury deregulation order should not be given collateral estoppel effect because the tenant was never served with a J-51 Notice. Rejecting this argument, the First Department held:

The receipt of J-51 benefits is a matter of public record. In addition, landlords have no affirmative duty to provide such written disclosure except to tenants who are subject to rent stabilization *solely* because of the receipt of J-51 benefits, which is not the situation here (italics in original, internal citations omitted).

Thus, the First Department in *Gersten* acknowledged that only tenants in Type B buildings are entitled to receive the J-51 Notice. This would appear to contradict any statement in *73 Warren* that luxury deregulation cannot be effectuated in Type A buildings unless J-51 benefits have expired and the owner served the J-51 Notice on the tenant.

The Type A/J-51 Notice issue was directly addressed in *Schiffren v. Lawlor*,[6] a 2011 decision by Justice Wooten in an Article 78 proceeding. There, the tenant in a Type A building, citing RSL §26 504(c), argued that because he had never been served with a J-51 Notice, DHCR had unlawfully deregulated his apartment. Supreme Court expressly rejected the tenant's claim that he was entitled to a J-51 Notice:

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. Therefore, the tenants of a unit that was already stabilized prior to the receipt of J-51 cannot receive notice pursuant to RSL §26 504(c). Adopting petitioner's interpretation would thus render the latter clause of the statute meaningless.

To support petitioner's interpretation of the statute, petitioner cites *Roberts v. Tishman Speyer Properties*, (13 N.Y.3d 270 [2009]). *Roberts*, however, holds that a rent stabilized unit that is located in a building receiving J-51 benefits, and would be subject to luxury deregulation but for such J-51 benefits, cannot be deregulated until such benefits expire. *Roberts* does not in any way support petitioner's interpretation of RSL §26-504(c). The Court therefor 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.

Another problem with interpreting *73 Warren* as requiring the service of a J-51 Notice as a prerequisite to luxury deregulation in Type A buildings is that such a holding would be dicta. The building in *73 Warren* was a Type B building. As such, the Court had presumably no occasion to determine how luxury deregulation is effectuated in a Type A building where J-51 benefits have already expired.

Any confusion surrounding *73 Warren* will be short lived. The tenant in *Schiffren* has perfected an appeal to the Appellate Division, First Department, which will be argued in the fall and should be decided before the end of the year. There, the First Department will have to decide whether the service of a J-51 Notice to a tenant in a Type A building is a prerequisite to luxury deregulation. Until then, practitioners should proceed with caution.

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Endnotes:

1. 2012 WL 2140177.

2. 13 N.Y.3d 270, 890 N.Y.S.2d 388 (2009).

3. 284 A.D.2d 174, 727 N.Y.S.2d 76 (1st Dept. 2001).

4. N.Y. Senate, Debate on L. 1985, ch. 288 and 289, June 29, 1985, at 6780-6781.

5. 88 A.D.3d 189, 928 N.Y.S.2d 515 (1st Dept. 2011).

6. 2011 WL 2323242 (Sup. Ct. N.Y. Co.).
