Court Splits on Major Capital Improvement Policy

In their Rent Regulation column, Warren A. Estis, a founding partner at Rosenberg & Estis, and Jeffrey Turkel, a partner at the firm, analyze a First Department ruling that on the question: *What should happen when an owner performs a building-wide Major Capital Improvement, but some apartments do not benefit from the work due to poor workmanship?*

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What should happen when an owner performs a building-wide Major Capital Improvement (MCI), but some apartments do not benefit from the work due to poor workmanship? Thus, for an example, an owner may install new windows in every apartment, but the windows may have been improperly installed in a handful of units.

In the recent case of *Terrace Court, LLC v. New York State Div. of Hous. & Comm. Renewal*, 79 A.D.3d 630, 914 N.Y.S.2d 43 (1st Dept. 2010), a majority of the Appellate Division, First Department held that the owner should be permanently denied MCI rent increases for the apartments that did not benefit from the work. The dissent held that the rent increases should merely be deferred until the necessary corrective work is performed.

The facts in *Terrace Court* are not complicated. In May of 2004, the owner of 202 Riverside Drive filed an MCI application with DHCR, seeking rent increases based on pointing and waterproofing work at a cost of $1,207,853. On Dec. 19, 2005, DHCR granted the MCI application, but permanently exempted five apartments from the increase, owing to complaints of persistent leaks. DHCR then affirmed that determination on administrative review.

In the subsequent Article 78 proceeding, the Supreme Court (Solomon, J.) upheld DHCR's determination, holding that DHCR was justified in permanently denying MCI rent increases with respect to the five apartments in question.

The Majority Opinion

In an unsigned opinion, joined by Justices Angela M. Mazzarelli, Diane T. Renwick and Nelson Roman, the majority affirmed the Supreme Court in all respects.

The majority held that DHCR's determination was entitled to deference, and that the owner had failed to establish that DHCR had acted irrationally. The remainder of the majority's opinion was devoted to addressing the dissenting opinion, and to distinguishing the First Department's recent determination in *Langham Mansions, LLC v. New York State Div. of Hous. & Comm. Renewal*, 76 A.D.3d 855, 908 N.Y.S.2d 10 (1st Dept. 2010).

In *Langham Mansions*, the owner of 135 Central Park West replaced 860 oversized and non-standard windows throughout the subject building. The owner then applied to DHCR for MCI rent increases based upon the owner's expenditure of more than $1.5 million.

Various tenants complained that the windows in their apartments did not properly function. Notwithstanding, on May 19,

2006, DHCR approved the MCI application in full.

The tenants thereafter sought administrative review. DHCR then ruled that the MCI rent increases should be permanently revoked in those four apartments where DHCR had found defective windows. In a subsequent Article 78 proceeding, Supreme Court (Shafer, J.) affirmed DHCR's determination, holding that DHCR's order was entitled to deference.

The First Department, however, disagreed. The court held that in at least one prior administrative determination, which DHCR failed to distinguish, DHCR held that its policy was to merely suspend MCI rent increases until the necessary repairs in individual apartments were completed. The majority in *Langham Mansions* summed up its determination as follows:

In any event, we find that simple common sense dictates suspending an increase rather than revoking it permanently. Suspension encourages the owner to rectify the problem if the owner wishes to ultimately recoup its investment in the windows. Revocation, on the other hand, is a result that benefits nobody when an owner has no incentive to make repairs or adjustments.

76 A.D.3d at 859.

Justice Helen E. Freedman dissented in *Langham Mansions*, holding that DHCR had acted rationally. Commenting on prior cases wherein DHCR had merely suspended rent increases in selected apartments, Justice Freedman wrote:

The majority's determination that DHCR's denial of rather than suspension of the MCI increases is irrational is not borne out by the record. The cases cited by petitioner and referred by the majority, that favor suspension rather than denial, are ones in which building owners either had not been afforded the opportunity to remedy the defects or had completed the repairs by the time they filed their administrative appeals.

76 A.D.2d at 859.

In *Terrace Court*, the majority distinguished *Langham Mansions* in two respects. First, in *Langham Mansions*, DHCR had initially granted the MCI increases that it thereafter suspended. The majority in *Terrace Court* wrote:

While the record contains no evidence of why DHCR adopted the policy against revocation, one can surmise that the policy was implemented to avoid the prejudice which would be visited on a landlord which relied in good faith, and for a lengthy period of time, on a rent increase, only to later lose it. Such a concern would not exist in this case, where petitioner never enjoyed a rent increase. Accordingly, there was no reason for DHCR to consider the policy that was applied in *Langham Mansions*.

914 N.Y.S.2d at 46.

Second, the majority focused on the degree to which repairs were necessary:

In *Langham Mansions* itself, this Court specifically noted that any necessary repairs would be "minor" and that the inspection report noting defects in the new windows "fails to conclude that any of the windows inspected were installed defectively or in an unworkmanlike manner." Here, in contrast, and contrary to the dissent's reading of the record, there is no evidence that only minor work would be called for if the landlord were granted an opportunity to cure the defects.

Id.

The Dissent

Justice Eugene L. Nardelli, in a strongly worded opinion joined by Justice David Friedman, dissented. The dissent first challenged the majority's finding that major repairs would be required with respect to the five apartments in Terrace Court wherein leaks persisted. The dissent implied that the tenants' complaints were principally designed to allow them to avoid paying the MCI rent increases:

In this case, there had not even been a prior finding that petitioner was not providing services. Indeed, it appears that the tenants complained only after the MCI application for a rent increase was filed. They had otherwise not made any complaints to the appropriate authority concerning petitioner's failure to provide services. There is no evidence in the record that the moisture, such as it was, resulted from petitioner's prior neglect of the building. Rather, it appears to have

resulted from petitioner's efforts to upgrade the building. In any event, nothing in the record supports any inference that further remedial work required "major" renovations, since the moisture apparently was not significant to the tenants until the landlord sought a rent increase.

914 N.Y.S.2d at 49.

The dissent continued:

Thus, logic dictates that the proper relief would be to suspend any increases for the apartments in question until petitioner had been given an opportunity to cure the defects, but, once the defects were cured, to permit prospective (only) increases. Permanently barring petitioner from obtaining an increase, when other tenants are paying the surcharge, is irrational.

Id. at 50.

The dissent then addressed itself to the majority's efforts to distinguish *Langham Mansions*. With respect to majority's assertion that *Langham Mansions* was distinguishable because DHCR's Rent Administrator, in the first instance, had granted the rent increases for the apartments in question, the dissent wrote:

Thus, by the majority's lights, everything rides on how the Rent Administrator decides the matter. Applying the same reasoning to the judicial system, a litigant who prevails in Supreme Court keeps the spoils of that win regardless of any error in the Supreme Court decision subsequently found by the Appellate Division.

Another troubling aspect of the majority's analysis is that its theory is just that—a theory conjured out of thin air by means of speculation and surmise. Nowhere, not in this case, not in the record or briefs for *Langham Mansions*, not in our decision in *Langham Mansions*, is the matter said to rest on the fact that the landlord had been receiving the increase. While the majority feels that the landlord's reliance on having received the rent increase barred revocation of the increase in *Langham Mansions*, it never explained why the landlord's expenditure of $1,207,853 in expectation of receiving the MCI increase in issue here counts for nothing.

Id.

Christina S. Ossi, who represented DHCR in *Terrace Court*, advised the authors that the owner therein has taken an as-of-right appeal to the Court of Appeals, which has directed that the owner's brief be filed in April. The Court of Appeals is expected to rule in this hotly contested case by the end of 2011.

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