

# Rent Overcharges

## *Treble Damages for a Previous Owner's Conduct*

SETTING the amount of rent a tenant may lawfully be charged is one of the major aspects of regulation under the Rent Stabilization system administered by the New York State Division of Housing and Community Renewal (DHCR). Tenants can recover charges in excess of the legal rent. One method for doing so is to file a rent overcharge complaint with the division. An owner is potentially liable for more than just the refund of any overcharge with interest. That is the penalty, under the Rent Stabilization Law, if the owner establishes that the overcharge was not willful.<sup>1</sup>

However, a rent overcharge is presumed willful unless the landlord proves "by a preponderance of the evidence" that it was not,<sup>2</sup> and "when an owner submits no evidence or when the evidence is equally balanced, the overcharge is deemed willful."<sup>3</sup> As to a willful overcharge occurring subsequent to April 1, 1984, the landlord is liable to the tenant for treble damages.<sup>4</sup>

What happens within this framework when the ownership of a rent stabilized apartment changes? Should the new owner be subject to treble damages as to overcharges collected by the prior owner? In other words, should there be carryover liability?

### **'East 163rd Street LLC'**

In a recent decision by Bronx County Supreme Court Justice Dianne T. Renwick in *East 163rd Street LLC v. New York State Division of Housing & Community Renewal*,<sup>5</sup> the court reviewed the Housing Division's imposing of treble damages on the landlord of an apartment building for rent overcharges collected by its predecessor. The decision provides a compendium of case law and statutory cites dealing with carryover liability for treble damages for rent overcharges.

The case was an Article 78 proceeding commenced by the current building owner seeking judicial review of a Housing Division order which had held it responsible for rent overcharges paid by the tenant to the previous owner as well as the current owner. Since the finding of a rent overcharge was undisputed, the only issue the court reviewed was the assessment of treble damages. It noted that its role in examining an administrative decision pursuant to CPLR Article 78 was the "limited one" of reviewing "the rationality of the agency's determination." As characterized by the court, the owner's "primary emphasis" in challenging the imposition of treble damages was that "the illegal rent had been instituted by the prior owner and the current owner made diligent efforts to cure the defect."

The court found no basis to support the owner's claim that its reliance on the amount of rent charged by the prior owner should shield it from damages for rent overcharges including treble damages. It pointed out that "[t]he Rent Stabilization Code explicitly permits carryover liability for treble damages," and referred to 9 NYCRR §2526.1(f) as setting forth the division's "carryover" policy.

9 NYCRR §2526.1(f)(2) provides that:

[f]or overcharge complaints filed or overcharges collected on or after April 1, 1984, a current owner shall be responsible for all overcharge penalties, including penalties based upon overcharges collected by any prior owner.

In contrast, as to overcharges collected before that date, pursuant to 9 NYCRR §2526.1(f)(1), "an owner will be held responsible only for his or her

portion of the overcharges, in the absence of collusion or any relationship between such owner and any prior owners."

According to the court, "[d]espite the clear language of the regulation," the owner argued that carryover liability is unlawful "relying upon a single case," i.e., *Heights Associates v. Bautista*.<sup>6</sup> In that case, a non-payment proceeding, the tenant had counterclaimed for rent overcharges and treble damages. The Civil Court had awarded the tenant treble damages on the ground that the landlord had offered no evidence to establish that the overcharge was not willful.

On appeal, the Appellate Term, Second Department, vacated the award in favor of the tenant, stating its view that treble damages could not be awarded against the landlord for the overcharges that were collected by the prior owner. The Appellate Term characterized carryover liability as "not provided for in the Rent Stabilization Law but [rather] a product of judicial decisions and

subsequent regulatory adoption." It described the rationale underlying that "extension of liability to subsequent purchasers" as being that "a purchasing owner has the opportunity to review the building's relevant history and to provide for protection in the sales contract against liability for rent overcharges."

The court in *Heights Associates* held there was "no sufficient predicate for the imposition of liability for the treble damages upon the subsequent owners." It reasoned that treble damages are not compensatory to the tenant but, like punitive damages, are penal in nature. As to punitive damages, the court noted, "the motive of one party cannot be imputed to another party" and such damages as a rule "cannot be imposed upon one who did not participate in the offensive conduct."

### **No Triple Damages**

The court in *Heights Associates* held that, in light of these principles, "treble damages cannot, consistent with the Rent Stabilization Law's requirement of willfulness ... ordinarily be imposed upon a current owner for the overcharges collected by the prior owner." Referring to 9 NYCRR §2526.1(f)(2), the court stated that "[t]o the extent that the Rent Stabilization Code extends liability for treble damages for such overcharges to current owners ... it is out of harmony with the statute that it is designed to implement and with established principles of law and cannot be applied."

The court in *East 163rd Street LLC* characterized the holding of the Appellate Term in *Heights Associates* as "surprising" and commented that what the petitioner in the case before it and the court in *Heights Associates* "seem to have overlooked" is that "carryover liability for treble damages had long been upheld by the Appellate Division, First Department, and more recently by the Appellate Division, Second Department." As examples, the court discussed in some detail the Second Department decision in *Brea v. Jackson Heights Properties*<sup>7</sup> and the First Department decisions in *Round Hill Management Company v. Higgins*,<sup>8</sup> *4947 Associates v. New York State Division of Housing and Community Renewal*<sup>9</sup> and *S.E. & K. Corp. v. State of New York Division of Housing and Community Renewal*.<sup>10</sup>

In *Brea*, a 2001 decision, the Second Department, citing *Jewnandan v. Commissioner, New York State Division of Housing and Community Renewal*,<sup>11</sup> stated that "DHCR can impose liability for such overcharges and penalties against new owners who take title to the building after the overcharge occurred." In *Brea*, however, the court did not impose such liability against the successor owners because they "did not take title to the property until after the proceedings before the DHCR were concluded, and a petition for admin-



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*A recent Bronx County Supreme Court decision provides a compendium of case law and statutory cites on carryover liability for treble damages for rent overcharges.*

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# Landlord-Tenant: Prior Owner's Overcharges

istrative review filed by the former owner was denied.”

Justice Renwick summarized the approach of the First Department cases as follows:

While the reliance by a new owner on the amount of rent charged by the prior landlord can subject the new owner to damages for rent overcharges including treble damages, the rule, at least in the First Department, is that carryover liability for treble damages will be imposed on a case-by-case basis, depending upon the succeeding owner's degree of knowledge or culpability as to an existing overcharge.<sup>12</sup>

In *Round Hill Management v. Higgins*, for example, the First Department affirmed the trial court's decision annulling the Housing Division's award of treble damages

against the successor owner. The court held that liability for treble damages “should depend on a finding as to whether the owner had reason to know that the amount it was charging was in excess of the lawful rent.”

In *Round Hill*, the court concluded that the predecessor owner had shown, by a preponderance of the evidence, that it did not have reason to know that the \$200 a month rent in effect for the apartment at the time it purchased the building was in excess of the lawful rent. There were ten other apartments identical to the apartment at issue, and the \$200 a month rent was equal to or lower than the rent being charged for all of those ten other identical apartments at the time the successor owner purchased the building, and also well below the market rate. Given these circumstances, the court concluded that it was “irrational to characterize the overcharge found by [DHCR] by application of its default formula [i.e., the formula used when there is a default in submitting a full rental history] as ‘willful.’”

By contrast, in *4947 Associates v. New York State Division of Housing and Community Renewal*, the First Department affirmed an award of treble damages against a successor owner. The court emphasized that the owner had “offered no proof to sustain its burden of showing that its rent overcharge was not willful and, indeed, it must have known from its own rent rolls that the rent was excessive since it was nearly double that of similar apartments in the same line in the building.”

Similarly, in *S.E.&K. Corp. v. State of New York Division of Housing and Community Renewal*, the First Department affirmed the trial court's denial of a successor landlord's application pursuant to Article 78 to annul the division's award of treble damages. As described by that court, the landlord's “excuse” was that “its inexperience as a landlord caused it to be misled by the advice of the prior owner that a fair market rent could be charged for the apartment once the tenant who was then in occupancy moved out.” The court held that the division had properly rejected that argument because the initial rent would have represented an unlawful increase even if the successor landlord were entitled to charge a fair market rent. The court further stated: “Nor is the overcharge excusable in this instance by the claimed unavailability of a full rental history from the prior owner when petitioner took title.”

Applying the principles from these cases to the situation before it, the

court in *East 163rd LLC* held that the successor landlord had “failed to establish by a preponderance of the evidence submitted to DHCR that it did not know or had no reason to know that the tenant was being overcharged.” It had explained, the court noted, only its alleged efforts to cure upon receiving the rent overcharge order, but had offered no proof of any efforts upon acquiring the property, such as an attempt to procure the rent history of the apartment from the Housing Division or from the prior owner. The court pointed out that if such inquiry had been made, it would have been readily discovered that the rent charged to the current tenant when he took possession was 51 percent higher than what the prior tenant had been charged. The court described that as a “draconian increase [that] should have raised serious doubts about its legality, absent an explanation.” Furthermore, commented the court, the successor landlord had not produced any evidence, such as a comparison of rent charged to similar apartments, that would have indicated that the rent being charged to the tenant was appropriate.

The court in *East 163rd Street LLC*, therefore, concluded that “under the circumstances herein”, namely, “where the landlord cannot meet its burden of establishing that it did not know or had no reason to know that its predecessor had imposed an illegal rent to its tenant,” the new owner's reliance on the rent charged by the prior landlord subjects the new owner to damages for rent overcharges, including treble damages. It was “clearly in harmony with pertinent regulations and case law,” commented the court, to require a new owner to make some effort to ascertain the reliability of the rent charged by its predecessor in order to avoid carryover liability for treble damages within the scope of a rent overcharge.

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1 New York City Administrative Code §26-516(a).

2 See 9 NYCRR §2506.1.

3. DHCR Policy Statement 89-2.

4. See New York City Administrative Code §26-516(a).

5. NYLJ, April 21, 2004, at p. 18, col. 3 (Sup. Ct. Bronx Co.).

6. 178 Misc. 2d 669, 683 N.Y.S.2d 372 (App. T 2nd Dep't 1998).

7. 281 A.D.2d 579, 723 N.Y.S.2d 49 (2nd Dep't 2001).

8. 177 A.D.2d 256, 575 N.Y.S.2d 842 (1st Dep't 1991).

9. 199 A.D.2d 179, 605 N.Y.S.2d 91 (1st Dep't 1993).

10. 239 A.D.2d 123, 657 N.Y.S.2d 601 (1st Dep't 1997).

11. 275 A.D.2d 495, 713 N.Y.S.2d 690 (2nd Dep't 2000).

12. NYLJ, April 21, 2004, at p. 19, col. 2.