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LANDLORD-TENANT

Court Rejects 'Colorable Claim' Standard for Attorney Fees

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Under Real Property Law Section 234 (RPL 234), when a residential lease provides for the landlord's recovery of attorney fees resulting from the tenant's breach of the lease, a reciprocal covenant is implied requiring the landlord to pay the tenant's attorney fees incurred as a result of, among other things, the tenant's successful defense of an action or summary proceeding that the landlord commenced arising out of an alleged lease default. In order for the tenant to become entitled to attorney fees, the tenant must be the "prevailing party," meaning that the result must be substantially favorable to the tenant.[1]

While the court has some discretion to deny attorney fees to the "prevailing party" in the underlying litigation, the courts have repeatedly held that such discretion should be exercised sparingly, and that attorney fees should not be denied to the prevailing party unless "bad faith is established on the part of the successful party or where unfairness is manifest."[2]

In December 2012, the Appellate Term, First Department issued its decision in *251 CPW Housing v. Pastreich*.[3] In *Pastreich*, the Housing Court found that the tenant was the prevailing party in the underlying summary proceeding and was awarded attorney fees. The Appellate Term reversed, based on its finding that the landlord's possessory claims against the tenant were of "colorable merit" at the time the summary proceeding was commenced. The Appellate Division, First Department, however, reversed the Appellate Term in its decision dated Jan. 6, 2015.[4] The Appellate Division rejected the Appellate Term's "colorable claim" standard and reinstated the award of attorney fees to the tenant.

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'Pastreich' Background

The facts as recited by the Appellate Division in *Pastreich* are as follows.

In August 1991, the landlord, 251 CPW Housing, and the tenant, Yitzhak Pastreich, entered into a rent-stabilized lease reciting a monthly rent of $5,747.52, but containing a rider which provided for a preferential rent of $3,000 per month on the condition that the tenant accepted the apartment in "as is" condition. The rider further provided that at the end of the term of the initial lease, the tenant had the option to renew with a new monthly preferential rent of $3,000 adjusted by the corresponding rent guidelines. The parties thereafter executed five lease renewals, each for a two-year term. The rent charged in the renewals was based on the original preferential rent, plus the applicable rent guideline increases. The fifth renewal lease, commencing June 1, 2002, had a preferential monthly rent of $3,715.64.

> A prevailing residential tenant who would otherwise be entitled to recover attorney fees under RPL 234 will not be denied such fees merely because the landlord can establish it had a "colorable claim" when the underlying action or proceeding was commenced.

In 2004, the landlord offered the tenant a renewal lease with no preferential rent stated, and instead set forth the legal rent of $7,652.26 per month. The landlord contended that a 2003 change in the Rent Stabilization Law allowed it to discontinue the preferential rent. The tenant, believing that he was entitled to a preferential rent, refused to execute the renewal lease. In November 2004, the tenant filed an overcharge complaint with the New York State Division of Housing and Community Renewal (DHCR).

In January 2005, while the DHCR proceeding was pending, the landlord commenced a summary holdover proceeding in the Housing Court. Ultimately, after the landlord moved for summary judgment, the Housing Court stayed the motion and marked the holdover proceeding off calendar pending the conclusion of the DHCR proceeding.

After DHCR denied the tenant's overcharge complaint, the tenant brought an Article 78 proceeding alleging that DHCR acted in an arbitrary and capricious manner by failing to conduct an evidentiary hearing. The Supreme Court dismissed the proceeding but the Appellate Division reversed, rejecting the landlord's reliance on the 2003 change in the Rent Stabilization Law as permitting it to discontinue the preferential rent as set forth in the lease. The Appellate Division remanded to DHCR for a hearing on the parties' intent as to the duration of the preferential rent as set forth in the lease. Upon remand, DHCR, after a hearing before a DHCR administrative law judge, concluded that the parties had intended and agreed that the preferential rent would continue for the duration of the tenancy. The landlord did not seek further review of this decision.

The tenant then moved in the Housing Court proceeding for an award of attorney fees under RPL 234, based on his having prevailed in that proceeding. The tenant sought his fees incurred in the holdover proceeding, as well as the DHCR and Article 78 proceedings. The Housing Court granted the tenant's motion and restored the matter to the calendar for a hearing on the amount of the attorney fees to be awarded.

The Appellate Term, First Department reversed the Housing Court and denied the tenant's motion for attorney fees, based on its finding that the landlord had a "colorable" claim at the time the holdover proceeding was commenced.[5] The Appellate Term held:

> Tenant's motion for attorney fees should have been denied because landlord's possessory claim, relying largely on the 2003 rent law amendments embodied in Rent Stabilization Law…§26-511[c][14], was of colorable merit at the time this 'summary' eviction proceeding was commenced in or about January 2005, as reflected by the lengthy and circuitous history of the related DHCR and Article 78 proceedings between the parties. Although 'entitlement to attorney fees under a lease clause is a matter of contractual right, a court's authority to withhold fees in a particular case is not so closely confined and may turn upon equitable factors or other considerations fact-specific to the litigation.' We note, in any event, that tenant would not be entitled to recover counsel fees in connection with the related agency and CPLR Article 78 proceedings.[6]

Appellate Division Ruling

In a unanimous opinion, the Appellate Division (Mazzerelli, J.P., Renwick, Andrias, Richter and Feinman, J.J.) reversed.[7]

At the outset, the court rejected the Appellate Term's "colorable merit" standard as being "an improper standard" in denying a prevailing tenant his attorney fees.[8] In so ruling, the court explained that the application of such a standard to deny a tenant attorney fees would gut the protections afforded by RPL 234:

> The overriding purpose of Real Property Law §234 is to provide a level playing field between landlords and tenants, creating a mutual obligation that provides an incentive to resolve disputes quickly and without undue expense.' Because it is a remedial statute, Real Property Law §234 'should be accorded its broadest protective meaning consistent with legislative intent.' The Appellate Term's conclusion that a tenant's claim to reciprocal attorney fees can be denied whenever a landlord asserts a colorable claim undermines the salutary purpose of Real Property Law §234. A 'colorable claim' standard would result in the gutting of the protections afforded by the statute because it would allow courts to deny fees whenever the landlord can make a nonfrivolous legal argument in support of its position.[9]

The court stated that the discretion to deny attorney fees to a prevailing party should be exercised "sparingly," and should be done "only where a fee award would be manifestly unfair or where the successful party engaged in bad faith."[10] The court then went on to explain that no such manifest unfairness was present in the instant case.

The Appellate Division found that the fact that the landlord may have relied on the 2003 amendment to the Rent Stabilization Law in rescinding the tenant's preferential rent and bringing the holdover proceeding did "not render an award of attorney fees manifestly unfair."[11] The court also observed that the landlord had pointed "to no case law, either at the time it commenced the holdover proceeding or now, supporting its view that it could charge the tenant the legal regulated rent in the face of a lease agreement promising a preferential rent for the tenancy's duration."[12] The court explained that, in fact, the case law existing at the time the holdover proceeding was commenced supported the contrary view. The court pointed to its 2011 decision in *Matter of Missionary Sisters of Sacred Heart, Ill. v. New York State Div. of Housing. & Community Renewal*,[13] which found that an earlier Rent Stabilization Code provision on preferential rents was not intended to obviate the terms of the parties' lease.

The court then went on to reject the Appellate Term's reliance on various decisions from the Appellate Division, as purporting to support the determination to deny the tenant attorney fees.

The Appellate Division explained that its 2012 decision in *Kralik v. 239 E. 79th Owners Corp.*,[14] relied on by the Appellate Term, did not justify the Appellate Term's conclusion. The Appellate Division stated that *Kralik*, which affirmed the motion court's denial of attorney fees to the plaintiff, did not use a "colorable claim" standard. Furthermore, unlike *Pastreich*, at the time the Kralik litigation was commenced, "the defendant cooperative's position was supported by appellate precedent," which was later rejected by the Court of Appeals.[15]

The Appellate Division also rejected the Appellate Term's reliance on *Wells v. East 10th St. Assoc.*[16] The court explained that in *Wells*, the Civil Court had granted the defendant landlord summary judgment based on an Appellate Division, First Department decision which was subsequently reversed by the Court of Appeals. Thus, in light of the change in appellate authority, the Appellate Division "found no abuse of discretion in denying the Wells plaintiff attorney fees."[17] The court found that "[n]o similar change in the controlling appellate precedent is presented here."[18]

Thus, the Appellate Division reinstated the tenant's claim for attorney fees. The Appellate Division, however, found that the Appellate Term had correctly excluded from such claim any attorney fees expended in the DHCR and Article 78 proceedings. The court observed that "[i]t is well settled that the right to attorney fees under Real Property Law §234 does not extend to these types of proceedings" and that "[t]his is true even where the administrative proceeding is related to the summary possession proceeding."[19]

Conclusion

The Appellate Division made some things clear in *Pastreich*. For one, a prevailing residential tenant who would otherwise be entitled to recover attorney fees under RPL 234 will not be denied such fees merely because the landlord can establish it had a "colorable claim" when the underlying action or proceeding was commenced. Second, while it may be appropriate to deny attorney fees to a prevailing tenant in certain circumstances, such circumstances are limited to where a fee award would be "manifestly unfair or where the successful party engaged in bad faith."

The First Department also clearly suggested that, based on its prior decisions, it may be "manifestly unfair" to award attorney fees to a prevailing tenant where the landlord's claim was initially supported by controlling appellate precedent, but that precedent subsequently changed. In what other limited circumstances it might be "manifestly unfair" to grant attorney fees to a prevailing tenant is not addressed in *Pastreich*, and this of course would have to be determined on a case-by-case basis.

1. *Walentas v. Johnes*, 257 A.D.2d 352, 254 (1st Dept. 1999).
2. *Jacreg Realty Corp. v. Barnes*, 284 A.D.2d 280 (1st Dept. 2001).
3. 37 Misc. 3d 138(A) (App. Term, 1st Dept. 2012).
4. 2015 N.Y. Slip Op. 00208, 2015 WL 59141 (1st Dept. 2015).
5. 37 Misc. 3d 138(A), supra.
6. Id. (internal citations omitted).
7. 2015 N.Y. Slip Op. 00208, 2015 WL 59141, supra.
8. 2015 WL 59141 at *3.
9. Id.
10. Id.
11. Id. at *4.
12. Id.
13. 283 A.D.2d 284 (1st Dept. 2011).
14. 93 A.D.3d 569 (1st Dept. 2012).
15. 2015 WL 59141 at *4.
16. 205 A.D.2d 431 (1st Dept. 1994).
17. 2015 WL 59141 at *4.
18. Id.
19. Id. at *5.