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Accidental J-51 Benefits Do Not Lead to RSL Coverage

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In its April 3, 2012 decision in *Denza v. Independence Plaza Assoc.*, __A.D.3d__, 941 N.Y.S.2d 130 (1st Dept. 2012), the Appellate Division, First Department held that the New York City Department of Housing Preservation and Development's (HPD) erroneous continuation of J-51 benefits at the Independence Plaza North (IPN) housing complex after the complex left the Mitchell-Lama program did not subject the complex to rent stabilization coverage.

Background

IPN is a Manhattan housing project constructed in 1974 under Private Housing Finance Law (PHFL) Article II, known as the Mitchell-Lama program. As a Mitchell-Lama project, IPN was eligible to apply for J-51 tax benefits based on certain renovation work the owner had performed. In 1998, IPN received J-51 benefits, which were to expire in 12 years.

In 2003, the owners of IPN began the process, under PHFL §35(2), of withdrawing the complex from the Mitchell-Lama program. Upon dissolution, IPN would not be subject to the Rent Stabilization Law. This is because §5(a)(5) of the Emergency Tenant Protection Act (L.1974, c. 576, §4) provides that rent stabilization coverage shall not apply to "housing accommodations in buildings completed…on or after January first, nineteen hundred seventy-four."

In 2004, the owner worked out a deal with the IPN tenants whereby, after the Mitchell-Lama dissolution, (1) tenants qualifying under the Section 8 program would have their rents set by HPD, and (2) non-qualifying tenants, although not protected by rent stabilization, would receive rent adjustments tied to annual Rent Guidelines Board increases.

On June 28, 2004, the owner of IPN notified the New York City Department of Finance (DOF) that the project had left the Mitchell-Lama program, such that "the property shall forthwith be restored to a full taxpaying position" as of that date. HPD, however, did not terminate the J-51 benefits at this time.

On May 23, 2006, upon notification from the owner, HPD informed DOF that the J-51 benefits should have been terminated as of the June 28, 2004 dissolution date. On April 3, 2006, the owner paid back all of the J-51 benefits, with interest.

Supreme Court

In December of 2005, various tenants at IPN commenced the *Denza* action, which was consolidated with a related matter. See, *Independence Plaza North Tenants' Ass'n v. Independence Plaza Assoc.*, 29 Misc.3d 868, 907 N.Y.S.2d 611 (Sup. Ct. N.Y.Co. 2010). The tenants asserted that the complex was subject to the Rent Stabilization Law pursuant to RSL §26-504(c). That section generally provides that rent stabilization shall attach to a building receiving J-51 benefits, unless the building is subject to the PHFL or has converted to cooperative or condominium status. The tenants argued that because IPN received benefits after the Mitchell-Lama dissolution, the complex necessarily became rent stabilized.

Denza was heard by New York County Supreme Court Justice Marcy S. Friedman. In 2009, the Supreme Court remanded the action to DHCR for an opinion as to whether the receipt of J51 benefits post-dissolution made the complex subject to rent stabilization. DHCR opined that it had not:

> In view of the fact that HPD terminated the J-51 tax abatement effective as of the dissolution date…, the complex was not effectively receiving benefits subsequent to leaving Mitchell-Lama regulations and, therefore, [Rent Stabilization Law] 26-504c [sic] would not be applicable…. Since IPN did not become subject to rent stabilization in the first place, 28 RCNY (5-03(f)(3) [sic]), the provisions of HPD's J-51 regulation that mandates continued rent regulation when J-51 benefits are revoked or waived and would accordingly not be applicable to this matter, since according to HPD the benefits never attached after dissolution.
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> 941 N.Y.S.2d at 133.

In her August 30, 2010 decision, Friedman declined to adopt DHCR's opinion and ruled that the complex was subject to rent stabilization. The Supreme Court relied on §507(f)(3) of HPD's J-51 regulations, which, at the time, provided that if a building were no longer subject to rent regulation (such as PHFL regulation under the Mitchell-Lama program), the Commissioner "shall withdraw J-51 benefits." The Supreme Court held that the regulation did "not provide for mandatory termination of J-51 benefits when a Mitchell-Lama project exits the program, and that IPN became subject to the Rent Stabilization Law upon exiting the program as a result of its receipt of J-51 benefits." 29 Misc.3d at 876.

The Supreme Court also held that because HPD terminated the J-51 benefits at the owner's "instance," such termination constituted a "waiver" of benefits. The court observed that §503(f)(3)(ii) provides that "[r]ent regulation shall not be terminated by the waiver or revocation of tax benefits," such that the purported waiver could not prevent the complex from becoming rent stabilized. 29 Misc.3d at 881.

Related Federal Action

In the meantime, a related federal qui tam action, *United States v. WB/Stellar IP Owner LLC*, 800 F.Supp.2d 496 (SDNY 2011), was making its way through the Southern District of New York. In the federal action, an IPN tenant suing on behalf of the United States sought reimbursement for certain enhanced Section 8 subsidies the government paid to the owner. During the course of that action, the District Court was called upon to determine, inter alia, whether IPN was subject to rent stabilization by virtue of its post-dissolution receipt of J-51 benefits. The court (Scheindlin, DJ) disagreed with the Supreme Court, holding that rent stabilization coverage had not attached:

_____Section 5-07(f)(3) unambiguously states that if a building ceases to be subject to rent regulation, the Commissioner '*shall* withdraw' J-51 benefits. The plain language of the statute requires immediate withdrawal of the J-51 benefits upon cessation of rent regulation. Any possibility that the regulation allows for agency discretion in the matter is made less likely by section 5-07(e) of Title 28 of the RCNY. That section provides that the Commissioner 'may' revoke J-51 benefits upon certain findings of owner misconduct. This contrast suggests that the drafters of the regulation knew precisely how to make agency power discretionary but decided not to do so in section 5-07(f)(3). Accordingly, section 5-07(f)(3), properly construed, makes revocation of J-51 benefits mandatory immediately upon cessation of a pre-existing form of rent regulation (italics in original).

_____800 F.Supp.2d at 510.

The District Court continued:

_____The cessation of PHFL regulation resulted in immediate, mandatory revocation of J-51 benefits by force of law. Therefore, any post-Exit Date receipt of J-51 benefits could not, by law, have triggered RSL regulation because the buildings were not authorized by the statutory and regulatory scheme to receive them. The Government's theory that the Owners' buildings automatically reverted to RSL regulation upon the Exit Date ignores the mandatory language of section 5-07(f)(3) and has no basis in either the text or scheme of the regulatory and statutory framework.

_____Id. at 511.

The Appeal

The original *Denza* matter thereafter reached the Appellate Division, First Department, on appeal. Justice David B. Saxe wrote the court's opinion, which was joined by Justices Angela M. Mazzarelli and Nelson Román. Justice Leland DeGrasse issued a dissenting opinion on a procedural matter, but otherwise "agree[d] with the majority's conclusions in all other respects." 941 N.Y.S.2d at 136.

The court reversed the Supreme Court, for essentially the same reasons cited by Scheindlin in the federal action:

_____We concur with Judge Scheindlin's reasoning in the federal matter, granting summary judgment to the owners. We hold that IPN's continued receipt of J-51 benefits after it exited the Mitchell-Lama program was merely the erroneous result of DOF's failure to adjust IPN's tax liability following its receipt of notice that the property would be restored to full taxpaying status as of June 28, 2004. That error did not create rent stabilized status for a development that was otherwise not subject to the Rent Stabilization Law.

_____It is true that the receipt of J-51 benefits may trigger the applicability of Rent Stabilization Law (Administrative Code) §26-504(c), which provides that the Rent Stabilization Law shall apply to dwelling units in buildings receiving J-51 benefits, as long as that building is not owned as a cooperative or a condominium and is not subject to rent control. Had IPN intentionally sought and obtained J-51 benefits when no other rent regulation applied to its units, its receipt of those benefits would have triggered rent stabilization. But IPN sought and obtained J-51 benefits while it was subject to the Private Housing Finance Law, so the Rent Stabilization Law did not become applicable to it by virtue of those payments.

_____941 N.Y.S.2d at 134.

The court then rejected the tenants' argument that HPD's right to terminate J-51 benefits upon dissolution was discretionary:

_____We find nothing in the mandatory language of the rule as it then stood that may be read to give the agency discretion as to whether an owner's J-51 benefits could survive the building's withdrawal from Mitchell-Lama, where no other rent regulation was ever applicable. In contrast, the preceding section, 28 RCNY §5-07(e), denominated 'Revocation or reduction of tax exemption and tax abatement for failure to substantiate claimed costs,' expressly gives HPD discretion and other types of circumstances.

IPN became ineligible to continue receiving J-51 benefits, as a matter of law, at the moment it exited Mitchell-Lama.

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