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Preferential Rent

Court Rejects Agency Interpretation of 2003 Statute
Warren A. Estis and Jeffrey Turkel, partners at Rosenberg Estis, review a recent case that highlights an ongoing controversy surrounding the intersection of preferential rent clauses and the 2003 amendment to the Rent Stabilization Law that unilaterally allows landlords to discontinue such rents at the end of a lease term.

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In the recent case of *Sugihara v. New York State Division of Housing and Community Renewal*,[1] New York County Supreme Court Justice Joan A. Madden ruled that DHCR had too broadly interpreted a 2003 amendment to the Rent Stabilization Law ("RSL") that unilaterally allows landlords to discontinue a preferential rent at the end of a lease term. The case highlights an ongoing controversy surrounding the intersection of preferential rent clauses and the 2003 amendment.

Background

A preferential rent is one that is lower than the legal stabilized rent. Preferential rents are usually given as a tenant inducement, or where the stabilized rent actually exceeds market levels.[2]

DHCR's predecessor, the New York City Conciliation and Appeals Board, took the draconian position (known as the "*Collingwood* rule") that a preferential rent is forever. Thus, if a landlord charged a preferential rent, all future rents for that tenant - and for any successor stabilized tenant as well - would be based on the preferential amount. DHCR ameliorated this rule in 1987 when it promulgated Section 2521.2(b) of the Rent Stabilization Code. That section provided that a preferential rent would only carry through the tenancy of the tenant to whom it was initially granted; upon vacancy, the rent could be based on the non-preferential level.

DHCR's regulation came under attack in *Missionary Sisters of the Sacred Heart v. DHCR*, 283 A.D.2d 284, 724 N.Y.S.2d 742 (1st Dep't 2001), wherein a sharply divided First Department ruled that where a lease expressly provides that a preferential rent shall be limited to a specified period, DHCR cannot override the parties' intent by forcing the landlord to calculate renewal rents over the preferential rent for the entirety tenancy. The Court ruled that the parties' intent should govern, given that public policy would not be offended if the tenant's rent were merely raised to a lawful, stabilized level.

The Legislature codified Missionary Sisters in 2003 when it amended the RSL to add new Section 26-511(c)(14), which states in relevant part:

> *. . . where the amount of rent charged to and paid by the tenant is less than the legal regulated rent for the housing accommodation, the amount of rent for such housing accommodation which may be charged upon renewal or upon vacancy thereof may, at the option of the owner, be based upon such previously established legal regulated rent, as adjusted by the most recent applicable guidelines increases and any other increases authorized by law.*

Second Department Rulings

The earliest reported case addressing the effect of the 2003 amendment was *Aijaz v. Hillside Place, LLC*, 3 Misc.3d 754, 774 N.Y.S.2d 652 (N.Y.C. Civ. Ct., Queens Co. 2004). In *Aijaz*, the landlord gave the tenant a preferential rent in consideration for the tenant's agreement to switch apartments in the building. After the initial lease expired, the landlord calculated the renewal rate above the non-preferential rent. Several years later, the tenant sued the landlord for rent overcharge.

Civil Court (Butler, J.) found for the tenant, ruling that the holding in *Missionary Sisters*, and DHCR's interpretation of that holding in an Aug. 19, 2003 Advisory Opinion, "do not apply where preferential rent was given for consideration and where the parties contracted that the preferential rent would be for the entire duration of the tenancy. The distinguishing issue in the case before the court is that the preferential rent in this matter was given in exchange for the Tenant relocating to a different apartment."[3]

A year later, the Appellate Term for the 2nd and 11th Judicial Districts affirmed.[4] The Court ruled:

This lease provided that the legal regulated rent was $810.47 but that, in consideration for his relocating to the subject apartment, plaintiff would receive a preferential rent of $758.21 for the term of the lease and any renewal leases, subject to adjustment in accordance with the Rent Stabilization Law.

* * *

As the court below implicitly ruled, the 2003 amendment was not intended to preclude the parties to a lease or stipulation from agreeing to a rent preference that would endure beyond the term of the lease into renewals periods. . . Plaintiff therefore has a cause of action sounding in contract for the refund of the rents that he paid in excess of the agreed-upon preferential rent.[5]

First Department Authority

In *448 West 54th Street Corp. v. Doig-Marx*, 5 Misc.3d 405, 784 N.Y.S.2d 292 (N.Y.C. Civ. Ct., N.Y. Co. 2004), the parties' original 1992 stabilized lease contained a preferential rent rider which provided that "the tenant will be charged during the Terms of Tenants' occupancy, a preferential rent."[6] In September of 2003 (following the enactment of the 2003 amendment pursuant to L. 2003, Ch. 82), the landlord offered the tenant a renewal lease with a rent based upon the non-preferential rent. The tenant refused to pay the increase, and a non-payment proceeding ensued. Judge Anthony J. Fiorella ruled for the tenant, holding:

Clearly, with the abrogation of the Collingwood *Rule in* Missionary Sisters *and Chapter 82 of the Laws of 2003, when a lease specifically limits the rent concession to the term of the lease, the landlord may charge the legal regulated rent, with any increases, upon renewal of the lease.*

* * *

Here, the application of Chapter 82 to the tenant's lease would substantially and severely impair the contract by depriving the tenant of the benefit of the bargain on the most essential term of the lease ¿ the amount of rent to be paid. The tenant, in entering the lease, relied on the promise of a preferential rent for the duration of the tenancy, and was entitled to and did order his personal and business affairs according to his need for an affordable apartment. . . .[7]

In *Colonnade Mgt., LLC v. Warner*, 11 Misc.3d 52, 812 N.Y.S.2d 209 (App. T. 1st Dep't 2006), the First Department followed the Second Department's lead in *Aijaz*, enforcing a preferential rent rider that "unequivocally and explicitly provide [d] for a rent concession for the duration of the tenancy.[8] In *Cromwell Assocs. v. Ortega*, 12 Misc.3d 141(A), 824 N.Y.S.2d 761 (App. T. 1st Dep't 2006), the First Department found for the landlord, holding:

While an express agreement between a landlord and tenant that a preferential rent will continue throughout the tenancy is enforceable [citation omitted], the underlying 1997 stipulation between the parties did not provide for a rent concession for the duration of the tenancy. Rather, the explicit terms of the stipulation limited the rent preference to the then current lease term and one additional renewal term. Thereafter, landlord was permitted to discontinue the preferential rent and resume the legal regulated rent.

'Sugihara'

In *Sugihara*, a rift between DHCR and the courts as to the proper interpretation of the 2003 amendment came into sharp focus. The 1991 lease rider in *Sugihara* was clear; the landlord agreed to charge the tenant a preferential rent of $800 per

month (the stabilized rent was $1,139.65), with the parties further agreeing that "all lease extensions after the first year will be based on $800.00 and increased in accordance with the guideline increases at the expiration of such lease." The landlord calculated rent increases above the preferential rent in lease renewals from 1992 through 2003. In 2005, possibly emboldened by the 2003 amendment, the landlord offered a renewal lease based on the non-preferential rent.

The tenant filed a complaint with DHCR citing, among other things, the ruling in *Aijaz*. In a Dec. 1, 2005 order, DHCR's deputy commissioner concluded that the language of the 2003 amendment was clear, and that "an owner may charge the legal regulated rent upon the renewal of a lease of a tenant who was paying a preferential rent," irrespective of what the lease rider might say. For good measure, DHCR added that it was not a party to the *Aijaz* case, and was thus not bound thereby.

Justice Madden pointedly annulled DHCR's determination. Citing *KSLM-Columbus Apartments, Inc. v. New York State Division of Housing and Community Renewal*, 5 N.Y.3d 303, 801 N.Y.S.2d 783 (2005), Supreme Court first held that because the matter concerned a pure question of statutory construction, DHCR's interpretation of the RSL was not entitled to deference. Having laid that groundwork, Supreme Court ruled that the 2003 amendment could not override the stated intent of the parties:

> *DHCR urges that the 2003 amendment to the Rent Stabilization Law gives the owner the right to issue a renewal lease based upon the legal regulated rent, notwithstanding the existence of a preferential rider in the parties' lease. Such interpretation, however, is not a correct reading of the unambiguous statutory language. Although section 26-511(c)(14) provides that on renewal of a lease with a preferential rent, the owner has the option of calculating the rent based upon either the preferential rent or the legal regulated rent, nothing in the plain language of the statute indicates or even suggests that it was intended to have the effect of revoking a landlord's and tenant's clear contractual agreement to continue the preferential rent indefinitely as the basis for calculating the rent for each and every renewal lease.*
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> *Here, the language in the 1991 lease rider clearly and unambiguously provides for a preferential rent during the duration of the tenancy. As the parties' intent is unequivocally and explicitly manifested in the written agreement, the agreement controls, and Sugihara is entitled to the benefit of the preferential rent throughout her tenancy.*

Stuart Birbach, counsel for the tenant in *Sugihara*, reports that DHCR and the landlord therein have filed notices of appeal.

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Endnotes:

1. 13 Misc.3d 1239(A) (Sup. Ct. N.Y. Co. 2006).

2. See, generally, Estis and Turkel, "Rent Regulations, Eight-Year Extension, New Legislation Renews Rent Laws Through 2011," N.Y.L.J., July 22, 2003 at 5, col. 2.

3. 3 Misc.3d at 757.

4. *Aijaz v. Hillside Place, LLC*, 8 Misc.3d 73, 798 N.Y.S.2d 840 (App. T. 2nd and 11th Jud. Dists. 2005).

5. Id. at 74, 76.

6. 5 Misc.3d at 406 (italics in original).

7. Id. at 408.

8. 11 Misc.3d at 53.