

Outside Counsel In the Wake of the ‘Roberts’ Decision, What Next?

In a decision that has rocked the world of New York residential real estate, *Roberts v. Tishman Speyer Properties, LP, et al.*,¹ the Court of Appeals recently held that thousands of unregulated “market” apartments at two Manhattan building complexes, Stuyvesant Town and Peter Cooper Village, were unlawfully removed from rent stabilization while the owners, Tishman Speyer and MetLife,² (defendants) received benefits under the city’s “J-51” tax abatement and exemption program.³

The ruling affects all of the 11,200 tenants at the complexes, including the tenants and former tenants of the approximately 3,000 apartments that had been unlawfully deregulated. Tens of thousands of additional tenants could be affected city-wide. (The authors’ firm submitted an amicus curiae brief in *Roberts* on behalf of the New York State Tenants and Neighbors Coalition, Inc. and Met Council, Inc. and represents Stuyvesant Town and Peter Cooper Village tenants in various matters.)

While the majority of the Court expressed some skepticism that defendants’ claims of dire financial consequences for the real estate industry would come true, the dissent, siding with defendants, invoked ancient history stating that “the Trojans would have done well to heed Cassandra.”⁴ Landlords claim that the decision amounts to an undeserved and unexpected bestowing of rent stabilization⁵ on market tenants which will result in financial and administrative chaos. For tenants the decision represents years of speculation and greed coming home to roost.⁶

In the wake of the decision, it is expected that market tenants throughout the city, who live in, or at one time lived in, buildings that still receive, or have ever received, J-51 tax benefits will file claims seeking rent stabilization status and rent overcharges. Rent-stabilized tenants in buildings that still receive J-51 tax benefits (and arguably in buildings that once received



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benefits) will be protected from high income rent deregulation. Landlords will be precluded from renting vacant apartments at market rents in buildings still receiving J-51 tax benefits at least until the benefits expire and possibly thereafter as well.

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Prospective or Retroactive?

A number of issues remain unresolved by the *Roberts* decision. The first threshold issue, noted by the Court itself, is the issue of retroactivity. The courts have established a three-part test to determine whether a ruling should be given only prospective effect: 1) whether it establishes a new principle of law, either by overruling clear past precedent on which litigants may have relied or by deciding an issue of first impression whose resolution was not clearly foreshadowed; 2) the prior history of the rule at issue and the impact of retroactive application upon its purpose and effect; and 3) any inequity that would be created by retroactive application.⁷

Defendants argued before the Court that if it were to find for the plaintiffs, the ruling

would meet all three requirements and be limited to prospective application. For instance, defendants argued that they had relied upon the Division of Housing and Community Renewal’s interpretation of the law for many years and could not have expected such a dramatic change in the law. The Court rejected similar arguments in *Gurnee v. Aetna Life & Casualty Co.*,⁸ where the plaintiff had also relied on a longstanding regulation. It is unlikely that the *Roberts* decision will only be applied prospectively. Such a ruling would essentially gut the decision itself by allowing the apartments at Stuyvesant Town and Peter Cooper Village, and tens of thousands of others throughout the city to remain market apartments despite the landlords’ receipt of J-51 benefits.

While the issue of retroactivity is easily resolved, courts will have to address three other significant issues: 1) the regulatory status of apartments that were deregulated by landlords prior to receipt of J-51 benefits; 2) the regulatory status of “market” apartments in buildings where the J-51 benefits have expired; 3) the measurement of damages.

Prior Deregulation

Over the years, many apartments throughout the city were deregulated and rented at market rents when the landlord was not in receipt of J-51 benefits. However, at some later time, the landlord applied for and began receiving J-51 benefits. What is the regulatory status of these apartments? No doubt landlords will argue that the *Roberts* decision only prohibits removing an apartment from rent stabilization when it is in receipt of J-51 benefits and that therefore apartments deregulated prior to receipt of the benefits may remain market even if at some later point in time the landlord began receiving such tax benefits. Tenants will argue that upon receipt of J-51 benefits any previously deregulated apartment is subject to rent stabilization.

Based upon the Court’s rejection of the defendants’ argument in *Roberts* that there are two classes of J-51 apartments (“new construction” and those previously subject to rent stabilization), an argument treating apartments differently based upon when the J-51 benefits were received should similarly

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fail. In addition, the clear import of the *Roberts* decision is that there is a quid pro quo for receipt of J-51 benefits: no apartment may be treated as a market apartment when a J-51 benefit is received.

Expiration of the Tax Benefit

Another unresolved issue is how the ruling applies to apartments in buildings where the J-51 benefits have expired. The reasoning of the decision seems to require that at least some apartments in such buildings must either remain rent-stabilized or revert to rent stabilization.

Dwelling units in a building receiving J-51 tax benefits remain subject to rent stabilization until the "first vacancy of such units after such benefits are no longer received" unless each lease and renewal lease for the tenant residing in that unit included notice in 12-point type of the approximate date of the J-51 expiration and the fact that the apartment would then be subject to deregulation. RSL §26-504(c). This is commonly referred to as the J-51 rider.

Under that provision, any tenant who had resided in an apartment when it was receiving J-51 tax benefits, who is still residing in the apartment, remains rent-stabilized even after expiration of the benefits unless the leases contain the J-51 rider. If the apartment had been unlawfully deregulated while the J-51 was in effect, the tenant may be entitled to an overcharge award and reregulation. If the apartment had not been deregulated prior to the expiration of the benefits, the tenant would remain exempt from high income rent deregulation since the apartment was one that had "become subject to" the RSL by virtue of receiving tax benefits.

It is expected that landlords will argue vociferously that they did not include J-51 riders in the leases of already regulated apartments because the rider provision was meant to apply only to apartments in buildings made subject to the RSL "solely" by virtue of J-51 benefits. The problem with this argument is that an almost identical argument was made and rejected in the *Roberts* case.

Measuring Damages

Claims for rent overcharge are subject to a four-year statute of limitations and courts cannot examine rent records from more than four years prior to the filing of a complaint. CLR 9213-a and RSL 26-516. The four-year rule would limit a tenant's recovery (or former tenant's recovery) to the difference between the current market rent and the rent on the "base date"⁹ four years prior to the filing of the complaint plus any lawful increases as authorized by the Rent Guidelines Board.¹⁰ The key variable under the four year rule is the date the apartment "turned over" from rent stabilization to market. If the turn over occurred within four years of filing the overcharge complaint the prior rent-stabilized rent can serve as the base for the current rent. However, if the turn over occurred more than

four years prior to the filing of the overcharge complaint, the base date rent will be a market rent.¹¹ The difference in potential overcharge awards, depending on the formula used, could be substantial.

The four-year statute of limitations, however, is not set in stone. It is well established that a court will look back more than four years to determine whether an apartment is rent-stabilized. *East-West Renovating v. DHCR*¹² Over the last several years courts have also recognized instances where a "default formula" should be applied to measure damages, rather than the rent paid on the base date. Under the "default formula" the lowest rent charged for a rent-stabilized rent apartment with the same number of rooms in the building on the base date is used to determine the rent. In *Partnership 92 LP v. DHCR*,¹³ the Court of Appeals held that it was proper for the DHCR to utilize the default formula where the rent records for the four year period were not "reliable." The Court reached a similar determination in *Thornton v. Baron*,¹⁴ several years earlier.

Landlords will argue that the decisions utilizing the default formula involve some type of fraudulent scheme, such as an illusory tenancy¹⁵ or a false non-primary residence,¹⁶ to set an unlawful rent. However, in a recent 3-2 decision, *Grimm v. DHCR*,¹⁷ the First Department applied the default formula where there was no illusory tenancy or false non-primary residence scheme. Tenants will argue that the underlying principle behind utilizing the default formula is a base date rent which is both unlawful and unreliable because the apartment has been unlawfully deregulated and there is no reliable rent registration, if any.¹⁸

Who Is Cassandra?

It may take years to resolve all of the questions left open by the *Roberts* decision. If landlords ultimately prevail on some of the significant outstanding issues, in particular the issue of prospective application, the *Roberts* decision will amount to a Pyrrhic Victory¹⁹ for tenants. If on the other hand, the essence of the *Roberts* decisions stands, the modern-day Cassandra was the unknown (or fictitious?) landlord attorney who warned: do not rely on the DHCR's mistaken interpretation of the statute.



1. —N.E.2d—, 2009 WL 3378513 (N.Y.), 2009 N.Y. Slip Op. 07480.

2. Tishman Speyer is the current owner, MetLife the prior owner.

3. Landlords receive tax benefits under the Administrative Code of the City of New York §11-243 (previously J-51) to offset the costs of renovations. Under the J-51 program, a landlord's receipt of tax benefits is conditioned on maintaining apartments as rent-stabilized. 28 RCNY 5-03(f). The Rent Stabilization Law (RSL) provides for deregulation when the rent for a vacant apartment reaches \$2000 (vacancy deregulation) or when the household income is \$175,000 or more for two consecutive years and the legal regulated rent is \$2000 or more (high income rent deregulation). RSL §§26-504.1, 26-504.2. The RSL also carves out an exclusion to deregulation for housing accommodations "which became or become subject to this law [i.e., the RSL] (a) by virtue of receiving tax benefits pursuant to section..four hundred eighty-nine

of the real property tax law [J-51 benefits]" RSL §§26-504.1, 26-504.2. While the New York State Division of Housing and Community Renewal (DHCR) had historically construed the exclusion to apply only to housing accommodations that became subject to the RSL solely because of receipt of J-51 benefits (generally new construction), the Court held that the exclusion from deregulation also applies to apartments that had been rent-stabilized prior to the landlord's receipt of J-51 benefits.

4. In Greek mythology Cassandra was a daughter of the King of Troy. Apollo was enamored of her and gave to her the ability to predict the future. When Cassandra spurned him he put a curse on her so that her prophesies, even though correct, would never be believed. For instance, Cassandra warned the Trojans not to take a giant wooden horse into their city which they thought to be a victory trophy. The Trojans ignored Cassandra's warnings and Greek soldiers emerged from the "Trojan horse" to defeat them and to sack the city of Troy. See Homer, *The Iliad*.

5. While the decision concerned rent-stabilized apartments, the Rent Control Law carves out the same exclusion to vacancy and high income rent deregulation as exists under the RSL. NYC Adm. Code 26-403(j) and (k). This article does not address the unique issues that arise regarding rent controlled apartments.

6. Tenants point to the purchase of the property for \$5.4 billion as evidence of speculation and greed.

7. See *Gurnee v. Aetna Life & Casualty Co.*, 55 NY2d 184 (1982) which utilized the test set forth in *Chevron v. Huson*, 404 US 97, 92 S.Ct. 349 (1971).

8. 55 NY2d 184 (1982).

9. The RSL defines the "base date" rent as the rent "set forth on the annual registration statement." The Rent Stabilization Code, however, defines the base date rent as the rent "charged" on the base date regardless of the registration. RSC §2520.6(e) Which definition is utilized by the courts in the J-51 cases will have a substantial impact on the calculation of overcharges.

10. An overcharge award is also subject to 9 percent interest. RSL 26-516.

11. Rent overcharge calculations also have to factor in "vacancy increases" and 1/40th of the cost of renovations to a vacant apartment. RSL §§26-511(c) (5-a), 26-511(c) (13).

12. 16AD3d 166, 791 NYS2d 88 (1st Dept 2008).

13. 11 NY3d 859, 873 NYS2d 247 (2008).

14. 5 NY3d 175, 800 NYS2d 118 (2005).

15. In an illusory tenancy scheme the apartment is rented to a person who does not reside there and then rerented at an unlawful higher rent to a third party.

16. In a false non-primary residence scheme the landlord charges more than the legal rent based on the false claim that the apartment will not be used as a primary residence and therefore is not subject to rent stabilization. *Levinson v. 390 West End Ave LLC*, 22 AD3d 97, 802 NYS2d 659 (1st Dept 2005).

17. —AD3d—, —NYS2d—, 2009 WL 3030206.

18. The RSL also provides that a tenant can collect treble damages for the last two years of a willful overcharge. RSL 26-516.

19. The phrase is named after King Pyrrhus of Epirus, whose army suffered irreplaceable casualties in defeating the Romans at Heraclea in 280 BC and Asculum in 279 BC during the Pyrrhic War.

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