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LUXURY DEREGULATION: IMPACT OF THE NEW ACT

INCOME THRESHOLD SUBSTANTIALLY LOWERED TO $175,000; SUPREME COURT DECISIONS ADDRESS TENANT DEFAULTS

By Samuel J. **Himmelstein**

THE DUST from the war over the continuation of rent regulation has settled, resulting in significant changes in what is commonly referred to as "luxury" deregulation. As a result, many more apartments in New York City will be subject to deregulation. The immediate impact of these changes will be the loss of rent and eviction protections for many more tenants in New York City, and the permanent removal of many more apartments from the regulatory system as they are vacated.

In 1993, the State Legislature enacted the Rent Regulation Reform Act of 1993, which permitted the deregulation of a limited number of apartments in New York State and New York City. One year later, the City Council expanded the state version by permitting deregulation of all apartments which rent for over $2,000 and (a) where the annual household income exceeded $250,000 for two consecutive years, or (b) when the apartment became vacant.

According to the Division of Housing and Community Renewal, thousands of apartments have been deregulated under these statutes. Tenants now residing in those apartments have only their leases and the whims of the marketplace to protect them from arbitrary eviction and rent increases. (See "Luxury Deregulation: A Boon for Landlords, a Bane for Tenants," NYLJ, March 11, 1996). This article will not re-examine the basic procedures of deregulation, but discuss and analyze the changes resulting from the newly enacted legislation, which apply to rent-stabilized and rent-controlled apartments.

The New Legislation

As only a hermit would be unaware, in June 1997 the State Legislature passed the Rent Regulation Reform Act of 1997 (1997 RRRA), which amended numerous housing statutes and renewed the rent control and rent stabilization laws for a period of six years. Some of the most profound changes in the law were in the area of luxury deregulation.

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First, effective Jan. 1, 1998, the 1997 RRRA substantially lowered the income threshold required for deregulation to $175,000; thus, if a tenant's total annual income exceeds $175,000 for each of the two years before the year in which the petition is filed, the apartment will, upon issuance of an order from the Division of Housing and Community Renewal (DHCR), become exempt from the protections of rent control or rent stabilization.

During the fight in Albany, many landlords advocated that luxury deregulation should be based upon a system of "averaging" the tenant's income for the two-year period, in order to prevent tenants from manipulating their income. This change was not included, so the statute still requires an income above the threshold for each of two consecutive years. Therefore, a tenant whose income exceeds the threshold in one of the relevant years and is $174,000 the next will not be deregulated, since the statute requires two consecutive years above the income baseline.

Tenant advocates have argued that the two-consecutive-year requirement is necessary to avoid deregulation where a tenant has an aberrantly high income in a particular year.

Vacancy Deregulation

Under the former city law, a vacancy combined with a rent of over $2,000 resulted in deregulation. An ambiguity in the drafting of the former city legislation led tenant advocates to argue that following vacatur by the regulated tenant, the first tenant paying a monthly rent in excess of $2,000 was subject to rent stabilization and only a subsequent vacancy would result in the apartment becoming deregulated.

Earlier in 1997, the City Council enacted Local Law No. 13 of 1997, which amended the Rent Stabilization Law. Under Local Law No. 13, for apartments becoming vacant after April 1, 1997, vacancy deregulation would not occur until the second tenant paying over $2,000 per month occupies the apartment. The new state legislation voids this city law, by exempting from regulation "any housing accommodation which is or becomes vacant on or after the effective date of the rent regulation reform act of 1997 with a legal regulated rent of two thousand dollars per month."

Market Rent Tenancies

Under the former legislation, landlords had not been required to continue renting the deregulated apartment to the formerly protected tenant, whether the tenancy was subject to rent control or rent stabilization. Under the new statute, landlords must, upon receipt of a decontrol order,

> offer the housing accommodation subject to such order to the tenant at a rent not in excess of the market rent, which for the purposes of this section means a rent obtainable in an arm's length transaction. Such rental offer shall be made by the owner in writing to the tenant by certified and regular mail and shall inform the tenant that such offer must be accepted in writing within ten days of receipt. The tenant shall respond within ten days after receipt of such offer.

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If the tenant declines the offer or fails to respond within such period, the owner may commence an action or proceeding for the eviction of such tenant.

While this provision permits an owner to commence an eviction proceeding against a tenant who declines or fails to respond to the offer, courts will presumably grant stays of eviction pending determination of whether the offer was in fact at a "market rent." The Civil Court has the statutory power to stay its own proceedings, including holdover proceedings, and the Supreme Court possesses the inherent power to issue such stays. Such stays could be applied for pending a declaratory judgment action seeking a ruling on whether the landlord's offer complied with the statutory criteria.

In these cases, as in use and occupancy hearings in landlord-tenant court following holdover proceedings, courts will presumably require that the landlord prove "market rent" by producing evidence of the rent of comparable (similar size, location, condition, amenities) apartments. Both sides would be advised to present expert testimony: real estate brokers and appraisers who are familiar with these comparability factors. This section also does not address whether the landlord must offer a lease, a duration of such lease, whether the lease is renewable by the tenant, or whether a month-to-month tenancy would comply with the statute.

Tenant Defaults

One aspect of deregulation which was not addressed by the new legislation was the question of defaults: the issuance of an order of deregulation when a tenant fails to respond, or responds late, to the landlord's petition for deregulation. Practitioners in this area have experienced the DHCR's adamant refusal to open defaults, even in cases where a tenant's answer was a few days late, or where the tenant alleges a valid excuse for not answering (language difficulties, confusion as to procedure) and produces proof that the annual income was below the threshold for the relevant years.

Much of the litigation in this area has focused upon the issue of tenant defaults and the constitutionality of various provisions of the statute, as implemented by the DHCR. Several Supreme Court decisions have issued, with mixed results.

Most courts, when faced with an Article 78 petition by a tenant seeking to overturn a DHCR default Order of Deregulation, have avoided sweeping pronouncements and made decisions on a fact-specific, case-by-case basis. In general, unlike the inflexible approach employed by DHCR, where the tenant has presented proof of an excusable default, coupled with a meritorious defense, the courts have vacated and remanded the proceeding to the DHCR. If one or both of these elements is absent, DHCR has been affirmed.

Thus far, no appellate court decisions have been issued, although several appeals are scheduled for argument this fall in the First Department.

In Dinnerstein v. DHCR, Index No. 114671/96 (Sup. Ct. N.Y. Co.), Justice Stanley Parness issued a decision dated Jan. 15, 1997, which found arbitrary and capricious DHCR's refusal to vacate a tenant's default so that the tenant could

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oppose a landlord's petition.

Justice Parness relied upon the tenant's immediate effort to vacate his default, following issuance of a default order, by filing an administrative appeal (PAR) and his confusion between the Income Certification Form (ICF) and the owner's Petition for Deregulation. Justice Parness further found that DHCR presumably possessed evidence indicating that the tenant's income did not meet the deregulation threshold.

Applying a traditional "excusable default/meritorious defenses" test used by courts to vacate defaults by litigants in judicial proceedings, Justice Parness remanded the case to DHCR for further proceedings. He subsequently recalled this decision because the parties to the litigation had resolved their differences, and the tenant's default was reinstated as part of a global resolution. The court's reasoning and analysis nonetheless remain instructive.

In Dowling v. DHCR, Index No. 115508/96 (Sup. Ct. N.Y. Co.), Justice Elliott Wilk overturned DHCR's denial of a Petition for Administrative Review (PAR) of a default Order of Deregulation, based upon the tenant's submission to the DHCR of proof that the tenant's income was below the threshold, and the absence of proof that the tenant had received the landlord's petition for deregulation. This ruling has been appealed.

In Vahab v. DHCR, Index No. 117520/96 (Sup. Ct. N.Y. Co.), Justice Louise Gruner Gans vacated a default order where the DHCR had, in response to a deregulation petition filed subsequent to the default, denied the landlord's petition for deregulation. Although filed under a different docket number, one of the income years in question overlapped with a year included in the default order. Justice Gans held that

> DHCR was in possession of information that would have rebutted the presumption of excessive income, or at least created a question as to the application of the presumption to this case. By segregating each individual year's petition for deregulation, despite the fact that the agency's actual decision making process can run into two or three years, the DHCR opted to implement the statute mechanically, disregard relevant facts, and elevate form over substance.
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> The totality of the circumstances and the obvious inconsistencies between the two DHCR Orders, necessarily render arbitrary the final determination of the DHCR to deregulate the tenant's apartment.

Similarly in Elkin v. Roldan, NYLJ, Sept. 12, 1997, p. 26, col. 4 (Sup. Ct. N.Y. Co.), Justice William Wetzel vacated a default order based upon a tenant's answer which had been mailed 10 days after the 60-day deadline had elapsed. Noting that the tenant had presented a meritorious defense (income below the threshold in both relevant years), and that the default in answering was inadvertent, the court based its ruling upon the absence of prejudice and the strong public policy in favor of disposing of cases on the merits.

Several decisions have refused to vacate default orders, holding that the DHCR's

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strict application of the statutory procedures and entry of default orders of deregulation were neither arbitrary nor capricious. Booth v. Holland, Index No. 105540/97 (Sup. Ct. N.Y. Co.) (tenant did not rebut presumption of receipt of petition); Pledge v. DHCR, Index No. 118266/96 (Sup. Ct. N.Y. Co.) (court refused to vacate default where records indicated that tenant received the petition and failed to prove a household income below the threshold; court noted that had all of the apartment occupants submitted such proof, it would have considered a remand to the DHCR "in the interest of justice").

In Hecht v. DHCR, Index No. 51063/97, (Sup. Ct. N.Y. Co.), Justice Charles J. Tejada refused to vacate an order of deregulation where it was undisputed that the tenant had received the petition, and was unable to prove to DHCR, despite being offered an opportunity to do so, that she had mailed her answer.

Similarly in Nick v. DHCR, Index No. 120805/96 (Sup. Ct. N.Y. Co.), Justice Salvatore Collazo rejected a tenant's allegation of confusion as constituting excusable default and upheld a default order of deregulation affecting two apartments whose total rent was considered in determining whether the $2,000 threshold applied; this ruling has also been appealed.

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