SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: **HON. ARLENE P. BLUTH** **PART** **IAS MOTION 14**

Justice

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ELIZABETH CHERNETT, MICHAEL RAPIN, on behalf of themselves and all others similarly situated,

Plaintiff,

- v -

SPRUCE 1209, LLC,

Defendant.

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INDEX NO. 159188/2020

MOTION DATE 04/01/2021

MOTION SEQ. NO. 001, 002

DECISION + ORDER ON MOTION

The following e-filed documents, listed by NYSCEF document number (Motion 001) 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 29, 31, 33, 35, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 50, 52

were read on this motion to/for DISMISSAL.

The following e-filed documents, listed by NYSCEF document number (Motion 002) 25, 26, 27, 30, 32, 34, 36, 49, 51

were read on this motion to/for DISMISSAL.

Motion Sequence Numbers 001 and 002 are consolidated for disposition. The motion (MS001) by defendant to dismiss the complaint is denied. The motion (MS002) by proposed amici, the Rent Stabilization Association of New York City, Inc., Community Housing Improvement Program, Inc., and the Real Estate Board of New York, to dismiss the complaint is denied.

Background

This putative class action involves the state tax abatement program available for new housing developments commonly known as the 421-a Program. "Section 421–a of the Real Property Tax Law provides for an exemption from local taxation for certain new multiple dwellings. It explicitly provides authority for a local housing agency in a city with a population

of one million or more to exclude certain new multiple dwellings through the passage of a local law" (*Kew Gardens Dev. Corp. v Wambua*, 103 AD3d 576, 577, 961 NYS2d 48 [1st Dept 2013]).

The purpose of the law is clear: to incentivize developers/landlords to build more housing by providing property tax exemptions. A building receives those exemptions as long as it remains in the 421-a Program. Although there are different options a developer may choose, the general idea is that property taxes get phased in over a certain period of time. In exchange for this tax exemption, the apartments are classified as rent stabilized, which means that the rent increases are set by the Rent Guidelines Board ("RGB").

The issue in this case is the initial rent set by the landlord once these new developments are ready for occupancy. Pursuant to the Rent Stabilization Code "The initial legal regulated rent for a housing accommodation constructed pursuant to section 421-a of the Real Property Tax Law shall be the initial adjusted monthly rent charged and paid but not higher than the rent approved by HPD pursuant to such section for the housing accommodation or the lawful rent charged and paid on April 1, 1984, whichever is later" (Rent Stabilization Code § 2521.1[g]). Obviously, since these are new buildings built well after April 1, 1984 the key issue is the "initial adjusted monthly rent charged and paid."

Defendant observes that the Department of Housing Preservation and Development ("HPD") sets a rent schedule for the initial rents, referred to as a "Schedule of Maximum Rents." Defendant maintains that these HPD-approved rents usually exceed the market rates that owners could actually charge new tenants.

Plaintiffs (renters) contend that defendant (the owner of a building in Bushwick) registered an illusory initial rent for the apartments in the building by utilizing concessions.

Typically, a lease would include a concession for a free month. Plaintiffs complain that defendant did not register the prorated rent actually paid by the tenant and instead registered the higher rent. This allowed the defendant to raise the rent from a higher amount.

For instance, if defendant set the initial rent at $4,000 per month but gave a free month, defendant would register the $4,000 with the Department of Homes and Renewal ("HCR") instead of the prorated (sometimes referred to as the "net effective") rent paid by the tenant. Plaintiffs complain that this tactic is a scheme to evade rent stabilization by allowing defendant to state a high initial rent and then use a concession instead of lowering the rent to what the market could bear. Then, when it was time for a new lease, defendant applied the rent increase from RGB to the registered rent, which was higher than what tenant was paying. Plaintiffs argue that defendant was not permitted to register the higher rent as its first rent because that was not the amount actually paid by the renters.

Plaintiffs allege that when these apartments are advertised, the adjusted prorated rent is advertised instead of the monthly rent and the concession. Plaintiffs provide a hypothetical example of an apartment with a monthly rent of $3,000 but marketed with a month free. Plaintiffs point out that this apartment would be advertised with the $2,750 monthly rent as the "net effective rent."

Defendant and proposed amici offer a different view of the applicable law. Defendant claims that the concessions were only temporary limited rent concessions expressed in clear riders to the rents signed by the initial tenants. It maintains that the term "net effective rent" is not a defined concept in the law. Defendant argues that the concessions were provided based on construction issues as it was a new building. It emphasizes that the concession riders made clear the concession was temporary and was not a preferential rent.

Defendant insists that the case should be dismissed because plaintiffs have no claim for rent overcharge. It points to HCR Fact Sheet #40 which provides a definition for a preferential rent and specifically discusses rent concessions. Defendant concludes that the free month given during the initial lease term yields the conclusion that this was rent concession rather than a preferential rent. It points out that the case can also be dismissed based on the statute of limitations. Defendant observes that the plaintiffs here were not the first renters and the initial leases for their apartment were signed more than four years ago.

The proposed amici[1] also make a motion to dismiss and make similar arguments to defendant. They focus on the fact that the initial leases made clear that the concession was a one-time occurrence and no reasonable person reading the concession rider could think it was a preferential rent. Proposed amici emphasize that plaintiffs' view of the 421-a Program is misplaced. They insist that the construction of new housing reduces rents in a neighborhood and the entire program is based on these new apartments actually being occupied. Proposed amici observe that developers have construction financing to pay off, mortgage payments and payrolls to meet so quickly renting as many units as possible is key. They acknowledge that "developers often use temporary rent waivers to quickly rent up apartments, as many habitable apartments nevertheless have a host of punchlist items that have to be addressed" (NYSCEF Doc. No. 27 at 12). Proposed amici claim that developers do not want to wait until construction is completed or deal with requests for rent abatements from the initial tenants.

In opposition to defendant's motion, plaintiffs note that the entire purpose of the 421-a Program was to help a developer struggling to fill a new building by exempting them from

[1] The Court will consider the motion by proposed amici. Cleary, the proposed amici have a significant interest in the issues raised in the instant motion (*see New York State Senator Kruger v Bloomberg*, 1 Misc 3d 192, 197 [Sup Ct, NY County 2003]).

paying property taxes for a set term. Plaintiffs insist that the intent of the program was never to allow a developer to avoid paying property taxes and concoct a scheme to charge higher rents than what the tenants were actually paying. They also point out that for this particular building, the certificate of occupancy was issued on October 23, 2013 and defendant was still providing "construction concession riders" in January 2015. Plaintiffs insist that the "Job Overview" listing on DOB's website listed no jobs after August 2013.

Plaintiffs also note that using preferential rents are no longer permitted for setting a legal rent under the HSPTA (the recently passed housing law in 2019) but that calling something a concession would permit a landlord to evade this requirement. They observe that discovery is needed to explore the various leases and how concessions were used. Plaintiffs contend that the use of concessions continues and is a system utilized to evade the HSTPA.

Plaintiffs also complain that defendant came up with the term "net effective rent" and used this to market these units. They claim that the statute of limitations is not a bar to this case because this is a fraudulent scheme. Moreover, plaintiffs maintain that tenants cannot waive their rent stabilization rights.

In reply, defendant insists that the Court should adhere to the guidance from HCR and plaintiffs provided no reason why the Court should ignore Fact Sheet #40.It maintains that the tenants have not waived any rent regulation rights and, in fact, have received a benefit from the reduced rent.

Discussion

"On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. We accept the facts as alleged in the [pleading] as true, accord [the proponent of

the pleading] the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory" (*Leon v Martinez*, 84 NY2d 83, 87-88, 614 NYS2d 972 [1994] [citations omitted]). "At the same time, however, allegations consisting of bare legal conclusions . . . are not entitled to any such consideration" (*Connaughton v Chipotle Mexican Grill, Inc.*, 29 NY3d 137, 141, 75 NE3d 1159 [2017] [citation and internal quotations omitted]).

On a "motion to dismiss on the ground that the action is barred by documentary evidence, such motion may be appropriately granted only where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law"(*Goshen v Mut. Life Ins. Co. of New York*, 98 NY2d 314, 326, 746 NYS2d 858 [2002]).

The Court denies the motion. At this early stage of the litigation, plaintiffs have stated viable causes of action and defendant did not cite to any documentary evidence that utterly refutes plaintiffs' claims. If the Court assumes that the allegations set forth by plaintiffs are true (as the Court must do on a motion to dismiss), then they evidence a scheme to evade the requirements of the 421-a Program in order to charge higher rents. As alleged by plaintiffs, defendant provided leases for the initial occupants that included concessions for construction despite the fact that construction was completed. And defendant purportedly continued to use "construction concession riders" long after construction was completed. If plaintiffs' theory is accurate, then it demonstrates that defendant utilized preferential rents in the initial lease which is not permitted under the Rent Stabilization Code. The applicable provision requires a landlord to register the amount charged and paid.

Although defendant and proposed amici claim that offering a temporary concession based on construction cannot support plaintiffs' claims, more discovery is needed to explore the ways

in which these concessions were used. Information about when construction was completed and the justification for the concessions is necessary to determine whether these were actually concessions or functionally preferential rent.

For instance, plaintiffs attach plaintiff Chernett's lease dated February 26, 2019 and it lists a temporary rent concession rider (NYSCEF Doc. No. 45 at 31). Moreover, plaintiffs allege that Chernett received a free month as part of her lease. This raises questions about whether defendant used concessions for other tenants and when. Discovery may reveal that defendant routinely used rent concessions in the same way that a landlord might use preferential rent. Simply calling it a concession does not transform it into a permissible activity under the applicable statutory scheme. Alternatively, discovery might show that defendant had a good reason for granting concessions. But at this stage of the case, plaintiffs have alleged a cogent theory: that defendant manipulated the use of a concession to register higher rents than they were permitted.

DHCR Fact Sheet

Any discussion of a "concession" must be informed by Fact Sheet #40 which defines both preferential rents and concessions (NYSCEF Doc. No. 19). Even if the Court were to consider this document as a properly promulgated rule, it does not compel dismissal. This fact sheet identifies two types of concessions. One type of concession is where the prorated amount is charged which according to this fact sheet "is really the same as a preferential rent and will be treated as the same manner" (*id.*). The other type of concession is "a concession for specific months, as for example, where the lease provides that the tenant will not have to pay rent for one or more specified months during the lease term. This type of concession is not considered a preferential rent" (*id.*). And while defendant and proposed amici contend that this what occurred

here, the Court cannot make that factual determination on a motion to dismiss here, where plaintiffs allege that the units were marketed with the prorated rent (the net effective rent).

The Court also questions the utility of this guidance to the instant circumstances—there is no reason offered for why these two types of concessions should be treated differently when, in practice, they are functionally the same exact thing. The tenant is paying the same amount over the course of the lease term (assuming the tenant stays for the term and doesn't leave when the free months end). The hyperbolic example provided by plaintiffs of a landlord demanding rent for $33,000 per month with 11 free months on a 12-month lease highlights this issue. Obviously, that is not the factual scenario alleged here but that type of lease would effectively charge a tenant $2,750 per month and under defendant's theory it should be classified as concession rather than a preferential rent. That makes little sense.

Popolizio

Defendant points to a Court of Appeals case, *Century Operating Corp. v Popolizio* (60 NY2d 483, 470 NYS2d 346 [1983], in support of its motion for dismissal. In *Popolizio*, the Court of Appeals rejected a tenant's claim that a two-month rent concession should apply to the calculation of his rent for subsequent leases for his rent stabilized apartment where the concession was given for construction. That case does not compel dismissal of the instant action; this is not a situation where plaintiffs allege there was a one-time concession for construction. Rather, plaintiffs point to the suspected use of construction concessions long after construction was completed. And the reach of *Popolizio* to a building participating in the 421-a Program is unclear.

Statute of Limitations

The Court denies the branch of the motion by defendant that sought to dismiss based on the statute of limitations. Defendant is correct that there is a four-year statute of limitations and the initial leasing for this building happened largely outside that four-year period (which would go back to October 29, 2016). But that four-year limitations period does not foreclose the instant action because plaintiffs contend that this was a fraudulent scheme. "The rule that emerges from our precedent is that, under the prior law, review of rental history outside the four-year lookback period was permitted only in the limited category of cases where the tenant produced evidence of a fraudulent scheme to deregulate and, even then, solely to ascertain whether fraud occurred – not to furnish evidence for calculation of the base date rent or permit recovery for years of overcharges barred by the statute of limitations" (*Regina Metro. Co., LLC v New York State Div. of Hous. and Community Renewal*, 35 NY3d 332, 355, 130 NYS3d 759 [2020]).

And the First Department has held that "We reject defendant landlord's argument that the fraudulent exception to the four-year look back period applies only to a fraudulent-scheme-to-deregulate case. In the event it is proven that defendant engaged in a fraudulent rent overcharge scheme to raise the pre-stabilization rent of each apartment, tainting the reliability of the rent on the base date, then the lawful rent on the base date for each apartment must be determined by using the default formula devised by DHCR" (*435 Cent. Park W. Tenant Assn. v Park Front Apartments, LLC*, 183 AD3d 509, 510-11, 125 NYS3d 85 [1st Dept 2020]). Therefore, the Court denies this branch of the motion. Plaintiffs allege that the concessions were used for numerous apartments in the buildings and permitted defendant to seek higher rents than permitted.

Summary

The relevant provision of the Rent Stabilization Code is unambiguous: a developer participating in the 421-a Program must register "the initial adjusted monthly rent charged and paid." But the application of the provision to this case is unclear. Is the initial rent charged and paid the prorated amount (the "net effective rent") or is it the amount defendant cites in the lease? The Court is unable to make such a determination at this point of the litigation. There is no question that courts have recognized the concept of a concession in connection with a rent stabilized unit, particularly concessions due to construction. Whether the concessions provided here are actually concessions requires an exploration of the facts surrounding this building's leases. And it is unclear how concessions might apply to the 421-a Program.

The extent to which defendant and proposed amici point to riders in which tenants purportedly agreed that the free month was not a preferential rent is of no moment. Defendant's claim that because the tenant received a benefit, the Court cannot conclude that rent stabilization rights were waived is belied by the uncertainty with which these concessions were provided. Under plaintiffs' theory, it seems that the concessions were merely a recognition that the free market could not procure a tenant willing to pay the amount sought by defendant. In that scenario, the tenant did not receive a benefit. He or she merely signed a lease for a certain amount that the landlord chose to characterize as a 12-month lease with one month free instead of a 12-month lease at a lower rate. The effect on the tenant's bank account is negligible.

The Court also recognizes that defendant and proposed amici point to public policy concerns as a reason to dismiss this case. The Court disagrees. Defendant and other developers chose to participate in the 421-a program. The incentive to participate in the program is obvious: defendant receives tax exemptions to offset the high cost of construction and, in return, the

apartments must be rent stabilized while defendant is in the program. And, according to defendant, the cap on the rents that can be charged initially are usually higher than what the market could bear. So, in practice, a landlord can charge free market rents as the initial rent.

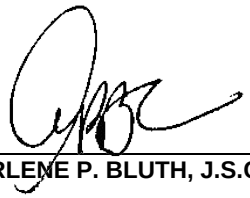
The issues with filling a new building with renters, as pointed out by the proposed amici, are not unique to 421-a buildings. They are common to every new development. It can be difficult to fill the buildings, pay off construction loans and make mortgage payments. But that is why the program includes tax exemptions; the taxpayers of this state are helping to subsidize the construction of the building while the developer constructs the building and markets the units. That the landlord may have to lower the first rent charged to the initial tenants is simply the free market at work. It is not a public policy reason to dismiss this case. A landlord need not participate in the program if it does not like the terms.

If defendant could have found a renter for its desired asking price, then it presumably would not have included concessions. Its claim that tenants would have demanded rent abatements absent the concessions is too speculative, on a motion to dismiss, to justify dismissal on this point. While it is reasonable to theorize (as defendant does) that a tenant living in a building under construction might demand an abatement, the fact is that a landlord can decide whether it wants to rent out the units before the building is completely finished. In this type of situation, the landlord will presumably make a calculated decision as to what makes the most financial sense.

Accordingly, it is hereby

ORDERED that the motions by defendant (MS001) and proposed amici (MS002) to dismiss are denied and defendant is directed to answer pursuant to the CPLR.

Remote Conference: June 22. 2021.



4/5/2021
DATE

ARLENE P. BLUTH, J.S.C.

CHECK ONE:		CASE DISPOSED		X	NON-FINAL DISPOSITION		
		GRANTED	X DENIED		GRANTED IN PART		OTHER
APPLICATION:		SETTLE ORDER			SUBMIT ORDER		
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN			FIDUCIARY APPOINTMENT		REFERENCE