2023-03-15

# Fabo v. Kushner Cos. LLC

At an IAS Term, Part 75, of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, at 360 Adams Street, Brooklyn, New York, on the 15th day of March, 2023.

PRESENT:

ROBIN S. GARSON,

Justice.

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NICHOLE FABO, J.L. BETANCOURT, ANNA SHEEHY, K.M. KACZOR, J.P. BROWN, MOIN HYDARI, K.E. LEWIS, A.J. BRESLOW, and ANDREW SHERMAN, on behalf of themselves and all others similarly situated,

Plaintiffs,

-against- Index No. 515806/17

KUSHNER COMPANIES LLC, 89 HICKS STREET LLC, and WESTMINSTER MANAGEMENT, LP,

Defendants.

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| The following e-filed papers read herein: | NYSCEF Nos.: |
|---|---|
| Notice of Motion/Order to Show Cause/ Petition/Cross Motion and Affidavits (Affirmations) Annexed | 135-138 |
| Opposing Affidavits (Affirmations) | 283-284 |
| Affidavits/ Affirmations in Further Support | 300 |

Upon the foregoing papers, plaintiffs Nichole Fabo, J.L. Betancourt, Anna Sheehy, K.M. Kaczor, J.P. Brown, Moin Hydari, K.E. Lewis, A.J. Breslow and Andrew Sherman, on behalf of themselves and all others similarly situated move for an order (a) granting plaintiffs summary judgment, (b) dismissing the affirmative defenses of defendants Kushner Companies LLC, 89 Hicks Street LLC (the Owner) and Westminster

Management, L.P.; (c) referring this matter to a Special Referee; and (d) awarding plaintiffs fees, costs and disbursements.

**Background**

In this class action, plaintiffs are current or former tenants of a multi-unit residential building at 89 Hicks Street in Brooklyn. The Watchtower Bible and Tract Society (Watchtower) purchased the subject building in 1989 and began listing the units with the New York State Division of Housing and Community Renewal (DHCR) as temporarily exempt from the Rent Stabilization Law (RSL)[1] and Code (RSC).[2] Prior to Watchtower's purchase, as indicated in the DHCR's Initial Registration Rent Roll Report effective April 1, 1984, the building contained units that were registered as either rent controlled or rent stabilized. In 2006, Watchtower sold the building to Brooklyn Law School for use as a dormitory, making certain units in building temporarily exempt from rent stabilization pursuant to RSC § 2520.11 [f]). The building was thereafter sold to the Owner on April 4, 2014.

According to the complaint, despite the transfer of the property to the Owner, which ended the temporary exemption and subjected the building to rent stabilization, the Owner failed to register the units and offer its first tenants rent stabilized leases, instead offering "free market" leases with rents exceeding the legal rent allowable under the RSL and RSC. Following commencement of this action, the Owner ostensibly recognized that the units which were occupied by rent stabilized tenants prior to the temporary exemption

[1] Administrative Code § 26-501 et seq.
[2] 9 NYCRR § 2520.1 et seq.

must be returned to rent stabilized status. Consequently, the Owner registered the units with the DHCR, reduced the rents to the purported legal regulated rents for those units and refunded overcharges to the tenants then in possession. With respect to those 13 units which were registered as rent controlled prior to the temporary exemption, the Owner offered the first tenants of those units following its purchase of the building free market leases with rents exceeding the $2,500 high-rent deregulation threshold then in effect, and thereafter continued to treat those units as properly deregulated.

In their answer, defendants set forth eight affirmative defenses: failure to state a cause of action (first); statute of limitations (second); that plaintiffs did not waive treble damages, thus precluding class action certification (third); that primary jurisdiction lies with the DHCR (fourth); failure to exhaust administrative remedies (fifth); that following commencement of this action, defendants registered the rent stabilized plaintiffs' apartments, adjusted the legal regulated rents and provided overcharge refunds (sixth); that overcharges were not willful (seventh); and that plaintiffs' claims are barred, in whole or part, by documentary evidence (eighth).

By order dated September 27, 2019 (Hon. Edgar B. Walker, J.), this action was certified as a class action.

## Discussion

***Request for Summary Judgment***

Plaintiffs move for summary judgment, dismissal of defendants' affirmative defenses and a referee to compute the overcharges using the "default formula" embodied

in RSC § 2522.6 (b) (3).[3] The default formula has been used in certain cases to calculate the "base date" rent upon which overcharges are determined. As relevant here, the "base date" is the date four years prior to the commencement this action (*see* RSC § 2520.6 [f] [1]). Under RSC § 2522.6 (b) (2) the default formula is applicable where either:

> (i) the rent charged on the base date cannot be determined; or
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> (ii) a full rental history from the base date is not provided; or
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> (iii) the base date rent is the product of a fraudulent scheme to deregulate the apartment; or
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> (iv) a rental practice proscribed under section 2525.3 (b), (c) and (d) of this Title has been committed.

RSC § 2525.3, which is cited in the above subsection iv, sets forth prohibitions on "Conditional rental[s]," and provides, in part:

> (b) No owner or other person shall require a tenant, prospective tenant or a prospective permanent tenant to represent or agree as a condition of renting a housing accommodation that the housing accommodation shall not be

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[3] Under the default formula, the rent is established at the lowest of the following amounts:

(i) the lowest rent registered pursuant to section 2528.3 of this Title for a comparable apartment in the building in effect on the date the complaining tenant first occupied the apartment; or

(ii) the complaining tenant's initial rent reduced by the percentage adjustment authorized by section 2522.8 of this Title; or

(iii) the last registered rent paid by the prior tenant (if within the four year period of review); or

(iv) if the documentation set forth in subparagraphs (i) through (iii) of this paragraph is not available or is inappropriate, an amount based on data compiled by the DHCR, using sampling methods determined by the DHCR, for regulated housing accommodations.

> used as the tenant's or prospective tenant's primary residence, or the prospective permanent tenant's principal residence.
>
> (c) No owner or other person shall require a tenant or prospective tenant to sign a lease or other rental agreement in the name of a corporation or for professional or commercial use as a condition of renting a housing accommodation when the housing accommodation is to be used as the primary residence of the prospective tenant for residential purposes.
>
> (d) No owner or other person shall engage in any practice, including but not limited to illusory or collusive rental practices which deprive a tenant in possession of his or her rights under this Code.

Plaintiff maintains that the default formula is applicable as the Owner engaged in a rental practice proscribed under RSC § 2525.3 (d) insofar as it engaged in a "practice" which "deprived a tenant in possession of his or her rights under the Code," specifically, the right to receive rent stabilized leases with properly calculated legal regulated rents. However, while the aforesaid regulation includes the common catch-all phrase "including but not limited to," the court does not interpret the regulation, as plaintiffs suggest, so broadly so as to require the default formula in every scenario where the owner deprives rent stabilized tenants of any rights under the RSL and/or RSC. Considering that the regulation is entitled "Conditional rental," the court interprets the catch-all provision in subsection (d) to be limited to practices (in addition to illusory or collusive practices) which involve a conditional rental between an owner and prime tenant designed to deny the tenant in possession (i.e., sublessee) rent stabilization rights, a situation not alleged in this action. Further, the Court of Appeals has made clear that the default formula only applies where the base date rent is unknown, unreliable, or the product of a fraudulent

practice; otherwise, in the absence of a fraudulent or collusive scheme to deregulate, the rent charged on the base date, even if improperly inflated, becomes the legal regulated rent upon which overcharges are calculated (*see Matter of Regina Metro. Co., LLC v New York State Div. of Hous. & Community Renewal*, 35 NY3d 332, 358-360 [2020])(*Regina*). In *Regina*, the Court of Appeals stated:

> "The rule that emerges from our precedent is that, under [the law applicable to the instant action], 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. In fraud cases, this Court sanctioned use of the default formula to set the base date rent. Otherwise, for overcharge calculation purposes, the base date rent was the rent actually charged on the base date (four years prior to initiation of the claim) and overcharges were to be calculated by adding the rent increases legally available to the owner under the RSL during the four-year recovery period. Tenants were therefore entitled to damages reflecting only the increases collected during that period that exceeded legal limits" (*Regina*, 35 NY3d at 355-356 [citation omitted]).

Under plaintiffs' open-ended interpretation of RSC § 2525.3 (d), application of the default formula would be required in every case where the base date rent is indisputably proper, but where the landlord overcharged the tenant in subsequent years; an interpretation clearly at odds with *Regina* and established case law (*see Matter of 333 E. 49th Partnership, LP v New York State Div. of Hous. & Community Renewal*, 165 AD3d 93, 105-106 [1st Dept 2018] [finding that the DHCR erred in applying the default formula in illusory tenancy matter where the rent reserved in base date lease was

reliable). While plaintiffs may argue that the Owner's provision of deregulated market leases to the first tenants of the building following the temporary exemption amounted to a fraudulent scheme, RSC § 2522.6 (b) (2) (iii) provides only that the default formula be employed where the "***base date rent is the product*** of a fraudulent scheme to deregulate the apartment" (emphasis added). Plaintiffs have not cited to, nor has this court found, any cases in which the default formula was applied in scenarios where the alleged fraud occurred following the base date.

Of course, in this matter the base date rents for the subject apartments do not exist as the base date fell during the temporary exemption period. Thus, it is necessary to apply the formula set forth in RSC § 2526.1 (a) (3) (iii), which provides:

> "Where a housing accommodation is vacant or temporarily exempt from regulation pursuant to section 2520.11 of this Title on the base date, the legal regulated rent shall be the prior legal regulated rent for the housing accommodation, the appropriate increase under section 2522.8 of this Title, and if vacated or temporarily exempt for more than one year, as further increased by successive two year guideline increases that could have otherwise been offered during the period of such vacancy or exemption and such other rental adjustments that would have been allowed under this Code."

Even though there were no base date rents for the subject units, the inapplicability of the default formula remains because reliable legal regulated rents may be established for those units formerly occupied by rent stabilized tenants using the aforesaid reconstruction formula. There is no allegation that the previous legal regulated rents prior to the temporary exemption were the product of a fraudulent or collusive scheme. Plaintiffs do not contend in their motion that there are no sufficient rental records to

allow calculation of legal rents for those apartments which were rent stabilized prior to the temporary exemption period under the reconstruction provision of RSC § 2526.1 (a) (3) (iii) or demonstrate in their motion that those legal regulated rents calculated by defendants following commencement of this action are incorrect under the RSC § 2526.1 (a) (3) (iii) formula.[4] Thus, use of the default formula in this instance would be tantamount to a penalty for the Owner's allegedly improper provision of market leases and overcharge of plaintiffs, which is not contemplated by case law and would not be allowable in a class action.[5]

The other essential contention set forth by plaintiffs is that the Owner improperly deregulated those 13 units which were formerly subject to rent control prior to the temporary exemption. Relying essentially on an Appellate Division, First Department decision (*Matter of AEJ 534 E. 88th, LLC v New York State Div. of Hous. & Community Renewal*, 194 AD3d 464 [1st Dept 2021]) and a decision of the Appellate Term, First Department (*West 88A LLC v "Jane Doe,"* 64 Misc 3d 73 [App Term, 1st Dept 2019]), plaintiffs assert that the first tenants in those units following the Owner's purchase should have been offered rent stabilized leases, as those units became rent stabilized when the rent-controlled tenants vacated, and returned to rent stabilization following the exemption period.

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[4] On the instant motion, plaintiffs do not offer their own calculations of rent based on the reconstruction formula to counter those registered and charged by the Owner.

[5] Courts have not required waiver of recourse to the default formula for proposed class actions as it is "not a penalty" (*Chernett v Spruce 1209, LLC*, 200 AD3d 596, 598 [1st Dept 2021], quoting *Simpson v 16-26 E. 105, LLC*, 176 AD3d 418, 418 [1st Dept 2019]).

"When a rent-controlled apartment becomes vacant, it becomes subject to the rent stabilization regime and the first rent is a market rent" (*Liggett v Lew Realty LLC*, 211 AD3d 473, 475 [1st Dept 2022]). Under the RSL, the initial rent for the first rent stabilized tenant is established pursuant to RSL § 26-512 (b) (2), which provides that

> "For housing accommodations which were regulated pursuant to the [Rent Control Law] on the local effective date of the emergency tenant protection act of nineteen seventy-four, and thereafter become vacant, the [initial regulated rent is the] rent agreed to by the landlord and the tenant and reserved in a lease or provided for in a rental agreement; provided that such initial rent may be adjusted on application of the tenant pursuant to subdivision b of section 26-513 of this chapter."

The aforesaid statute is mirrored in RSC § 2521.1 (a) (1), which states that "the initial legal regulated rent shall be the rent agreed to by the owner and the tenant and reserved in a lease . . . , subject to a tenant's right to a Fair Market Rent Appeal [FMRA] to adjust such rent." Upon service of an "RR-1" notice, the tenant must file a FMRA within 90 days. If the RR-1 notice is not served upon the tenant, then the FMRA must be filed no later than four years after decontrol of the rent-controlled apartment (*see* RSC § 2522.3).

The law in effect at the time of the Owner's first leasing of the relevant 13 formerly rent-controlled units provided that when the first tenant after the vacancy of the rent-controlled tenant is charged a rent at or above the rent stabilization deregulation threshold, the apartment is exempt from all forms of rent regulation (*see 3505 BWAY Owner LLC v McNeely*, 72 Misc 3d 1, 3 [App Term, 1st Dept 2021]; DHCR Fact Sheet

No. 6, Fair Market Rent Appeals [2020]). The court finds plaintiffs have not conclusively established that the 13 formerly rent-controlled units were not properly deregulated under the aforesaid statutory and regulatory schemes regarding initial regulated rents of former rent-controlled units which were vacated, even though there was a temporary exemption period between the vacancy of the rent-controlled occupancy and the initial rent stabilized occupancy. The cases relied on by plaintiffs in support of their argument that the 13 units remained rent stabilized despite the initial regulated rents exceeding the deregulation threshold are factually distinguishable. *Matter of AEJ 534 E. 88th, LLC* involved an apartment which, prior to a temporary exemption, was rent stabilized, not rent controlled, and thus did not concern the statutory and regulatory scheme concerning establishment of an initial regulated rent for the first rent stabilized tenant following a rent control vacancy.[6]

In *West 88A LLC*, the building at issue was originally subject to rent control but the subject apartment was decontrolled in or about 1954 due to occupancy by the Klopper family, the prior owner of the building. Upon the enactment of the Emergency Tenant Protection Act of 1974 (ETPA), the apartment became subject to rent stabilization, but was temporarily exempt from coverage because it was still occupied by the Klopper family. In August 2013, the building was sold to the current owner, but Harold Klopper was permitted to remain in occupancy of the subject apartment through January 31, 2014.

[6] The reconstruction formula of RSC § 2526.1 (a) (3) (iii) is not applicable since that regulation contemplates a prior "legal regulated rent" charged to a rent stabilized tenant in occupancy before the temporary exemption.

After Klopper's departure, the apartment was rented to the defendant tenant in April 2014, pursuant to an unregulated lease at a rent of $3,600 per month. In a subsequent holdover proceeding, the owner alleged that the defendant tenant had no right to continued occupancy as the apartment was unregulated. The Appellate Term agreed with the Civil Court that the apartment was rent stabilized. The Appellate Term stated that the apartment became subject to rent stabilization in 1974 pursuant to the ETPA, but was temporarily exempt because it was continually occupied by the Klopper family. The Appellate Term held that the apartment reverted back to its rent stabilized status upon the sale of the building.

*W88A LLC* does not necessitate a finding that the 13 formerly rent-controlled apartments were not deregulated when the first post-exemption tenants took occupancy. First, this court "is not bound by the precedents of the Appellate Term, either in [its] department or in other departments" (*29 Holding Corp. v Diaz*, 3 Misc 3d 808, 816 [Sup Ct, Bronx County 2004]). Second, *W88A LLC* is factually distinguishable in that the subject apartment became decontrolled by way of owner occupancy at a time when rent stabilization had yet to be enacted. The apartment in *W88A LLC* became rent stabilized upon the enactment of the ETPA in 1974, subject to a temporary exemption based on the pending owner occupancy. In this matter, the 13 units were occupied by rent controlled tenants in 1984, when the RSL was already in effect, and first became rent stabilized upon the vacancy of the rent-controlled tenants, subject to the temporary exemption. Significantly, the defendant in *W88A LLC* did not have the benefit of filing a FMRA, because the defendant's apartment, unlike the 13 subject units here, was not "subject to

the City Rent Law on December 31, 1973" (RSC § 2522.3 [a]). The *W88A LLC* court noted that the RSC did not establish any means for setting the initial legal rent for an apartment that was decontrolled in the mid-1950s, and first rented thereafter as a rent stabilized apartment more than a half-century later, and that in such "unique situation," the rent charged and collected from the tenant became the legal regulated rent, which the court determined remained subject to rent stabilization (*W88A LLC*, 64 Misc 3d at 76).

Plaintiffs also argue that the initial tenants of the 13 formerly rent controlled units were not deregulated insofar as the owner utilized rent concessions (i.e., offering leases for terms which included one or more rent-free months), thereby resulting in a "net effective rent" which did not surpass the deregulation threshold. Plaintiffs maintain that two First Department cases, *Flynn v Red Apple 670 Pac. St., LLC* (200 AD3d 607 [1st Dept 2021]) and *Chernett v Spruce 1209, LLC* (200 AD3d 596 [1st Dept 2021]), taken together, stand for the proposition that unless an owner can present a justifiable reason for rent concessions, an issue is presented as to whether the rent concessions were functionally equivalent to preferential rents, so that the "net effective rent" (i.e., total rent due under the lease term divided by the number of months in the term) should be deemed the initial regulated rent. The First Department cases cited are distinguishable insofar as they involved new units entering rent stabilization under the 421-a tax benefit program, rather than under vacancy by previous rent-controlled tenants. Also, whether the rationale of these cases should be applied to the final determination of plaintiffs' rent overcharge claims is ultimately an issue of fact regarding the Owner's motives.

Accordingly, the court finds that plaintiffs have not, at this juncture, established entitlement to judgment on their complaint as a matter of law. As a result, those parts of plaintiffs' motion for summary judgment, an order referring this matter to a referee to calculate rents using the default formula, and award of attorneys' fees and costs are each denied.

***Request to Dismiss Affirmative Defenses***

Turning to that part of plaintiffs' motion for dismissal of defendants' affirmative defenses, "CPLR 3211 (b) provides that '[a] party may move for judgment dismissing one or more defenses, on the ground that a defense is not stated or has no merit.' When moving to dismiss, the plaintiff bears the burden of demonstrating that the affirmative defenses 'are without merit as a matter of law because they either do not apply under the factual circumstances of [the] case, or fail to state a defense'" (*Shah v Mitra*, 171 AD3d 971, 974 [2d Dept 2019], quoting *Bank of Am., N.A. v 414 Midland Ave. Assoc., LLC*, 78 AD3d 746, 748 [2d Dept 2010]). "'On a motion pursuant to CPLR 3211 (b), the court should apply the same standard it applies to a motion to dismiss pursuant to CPLR 3211 (a) (7), and the factual assertions of the defense will be accepted as true'" (*Shah*, 171 AD3d at 974, quoting *Wells Fargo Bank, N.A. v Rios*, 160 AD3d 912, 913 [2018]). "'Moreover, if there is any doubt as to the availability of a defense, it should not be dismissed'" (*Shah*, 171 AD3d at 974, quoting *Wells Fargo Bank, N.A.*, 160 AD3d at 913).

That part of plaintiffs' motion seeking dismissal of defendants' first cause of action for failure to state a cause of action is denied. "[N]o motion by the plaintiff lies

under CPLR 3211 (b) to strike the defense [of failure to state a cause of action], as this amounts to an endeavor by the plaintiff to test the sufficiency of his or her own claim" (*Butler v Catinella*, 58 AD3d 145, 150 [2d Dept 2008]; *see Jacob Marion, LLC v Jones*, 168 AD3d 1043, 1044 [2d Dept 2019]; *Mazzei v Kyriacou*, 98 AD3d 1088, 1089 [2d Dept 2012]).

There is no limitations period with respect to claims seeking a declaration that an apartment is rent stabilized (*see Matter of 150 E. Third St LLC v Ryan*, 201 AD3d 582, 583 [1st Dept 2022]; *Gersten v 56 7th Ave. LLC*, 88 AD3d 189, 199-201 [1st Dept 2011]; *East W. Renovating Co. v New York State Div. of Hous. & Community Renewal*, 16 AD3d 166 [1st Dept 2005]). Under the law in effect when this action was commenced, claims for rent overcharge were subject to a four-year statute of limitations (former RSL § 26-516 [a] [2]; *see* former CPLR 213-a). As plaintiffs' claims for rent overcharge in this 2017 action are alleged to have accrued in 2014, when the first tenants took occupancy of the subject building following the expiration of the temporary exemption period, defendants' second affirmative defense of statute of limitations is without merit.

As a result, that part of plaintiffs' motion to dismiss the second affirmative defense is granted.

Defendants do not expressly oppose those parts of plaintiffs' motion seeking dismissal of the third, fourth and fifth affirmative defenses. Moreover, upon examination of the merits of these defenses, the court finds that dismissal is appropriate. The third affirmative defense that treble damages were not waived was rendered moot by the certification of this matter as a class action and resultant waiver of treble damages by

plaintiffs. Likewise, the fourth affirmative defense that the DHCR has primary jurisdiction over rent overcharge claims is no longer viable given the class action certification (*see Quinn v Parkoff Operating Corp.*, 178 AD3d 450, 451 [1st Dept 2019]). The Supreme Court has concurrent jurisdiction with the DHCR to hear rent overcharge cases (*see Downing v First Lenox Terrace Assoc.*, 107 AD3d 86 [1st Dept 2013]). Thus, plaintiffs need not exhaust their administrative remedies before seeking relief before this court, as plaintiffs were free to bring their rent overcharge claims before either this court or the DHCR (*see Nezry v Haven Ave. Owner LLC*, 28 Misc 3d 1226[A], 2010 NY Slip Op 51506[U], *4 [Sup Ct, NY County 2010]). Accordingly, the third, fourth and fifth affirmative defenses are without merit and are dismissed.

Defendants' sixth affirmative defense essentially sets forth that those apartments determined to be rent stabilized were registered with the DHCR; that affected tenants were provided with rent stabilized leases; and that these tenants were provided refunds of overcharges. The court finds that this affirmative defense is not completely without merit insofar as it is applicable to plaintiffs' claims regarding improper deregulation and rent overcharge.

Accordingly, that part of plaintiffs' motion to dismiss the sixth affirmative defense is denied.

Defendants' seventh affirmative defense that the overcharges were not willful is no longer applicable as any claim for treble damages was waived upon certification of this matter as a class action. While defendants argue in opposition that the issue of willfulness is a factor in whether or not defendants' actions were fraudulent, there is no

separate claim of fraud set forth in plaintiffs' complaint. As a result, that part of plaintiffs' motion to dismiss the seventh affirmative defense is granted.

Because plaintiffs do not address the eighth affirmative defense (documentary evidence) in their moving papers and memorandum of law, that part of plaintiffs' motion to dismiss the eighth affirmative defense is denied.

**Conclusion**

Accordingly, it is

**ORDERED** that those parts of plaintiffs' motion for summary judgment, appointment of a referee and an award of fees, costs and disbursements are each denied; and it is further

**ORDERED** that that part of plaintiffs' motion to dismiss defendants' affirmative defenses is granted to the extent that the second, third, fourth, fifth and seventh affirmative defenses are hereby dismissed; and it is further

**ORDERED** that that part of plaintiffs' motion to dismiss defendants' affirmative defenses is denied with respect to the remaining (first, sixth and eighth) affirmative defenses.

The foregoing constitutes the decision and order of the court.

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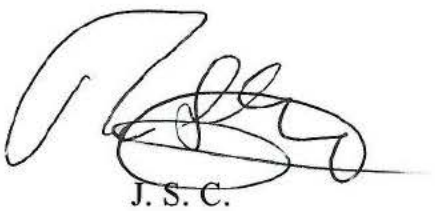

3-15-23

J. S. C.

HON. ROBIN S. GARSON
A.J.S.C.