Recent Court of Appeals Decision Invalidates HSTPA's Retroactive Application in Overcharge Cases

As you are likely aware, New York enacted the Housing Stability and Tenant Protection Act (HSTPA) on June 14, 2019. This sweeping package of laws and regulatory "reforms" has drastically altered the landscape of New York State's residential housing market, much to the detriment of landlords and property managers. Though a slew of legal challenges are currently pending in various courts across the state, historical challenges to rent-regulation have had limited success and, at this time, the HSTPA remains the law of the land.

While landlords continue to suffer from the debilitating effects of the HSTPA, New York's highest court recently dealt them a glimmer of hope when, on April 2, 2020, the Court of Appeals issued its decision on *Regina Metro. Co., LLC v. New York State Div. of Hous. & Cmty. Renewal, No. 1, 2020 WL 1557900*. While this decision was limited in scope to rent overcharges (stemming from deregulation while receiving a J-51 tax abatement) and did not address the constitutionality of the HSTPA as a whole, *Regina* still represents a major victory for landlords.

Prior to the HSTPA, rent-overcharge claims were governed by a strict 4-year analysis: landlords were only required to retain rent records for 4 years, overcharge awards were governed by a 4-year statute of limitations, and the courts were prohibited from examining the rental history prior to the "4-year base date" unless the tenant could establish a fraudulent scheme to deregulate. The *Regina* court noted that "*Together, the statute of limitations, lookback provision and record retention rules formed an integrated scheme for calculating overcharges based on a closed universe of records pertaining only to the apartment's rental history in the four years preceding the filing of the complaint.*"

By contrast, the HSTPA overcharge provisions increased the statute of limitations to 6 years, increased liability for treble damages, removed the record-retention rules, and gave the courts the power to examine the entire rental history to determine the legal regulated rent. While these changes were expressly intended to apply to overcharges occurring prior to June 14, 2019, the *Regina* court found that retroactive enforcement of the HSTPA overcharge provisions was unconstitutional. The court noted retroactive application of the new overcharge provisions violated due process because it substantially increased landlord liability for past acts without good cause or justification. Thus, the *Regina* court concluded that all overcharge claims accruing prior to June 14, 2019 would be governed by "the old rules" and that the new HSTPA overcharge rules could only apply prospectively.

The *Regina* decision has greatly limited exposure to overcharge liability and given landlords clear guidance on how to navigate housing court litigation going forward. Under *Regina*, the 4-year rule is determinative for all claims accruing prior to June 14, 2019 when the HSTPA was enacted. Thus, June 14, 2015 (4 years prior to the enactment of the HSTPA) has become the "perpetual base-date" for overcharge claims and landlords are now protected from rent increases occurring prior to June 14, 2015 unless the tenant can establish a "fraudulent scheme to deregulate". For the many landlords who became fearful of housing court litigation post-HSTPA, we encourage you to revisit your portfolios in light of *Regina.* Generally, "unexplained" rent increases and discrepancies in the registration history prior to June 14, 2015 should no longer be a prevailing concern so long as they are not so extensive as to suggest a

fraudulent scheme. Of course, the facts of each case are unique and if you have any questions as to how this case law can be applied, please feel free to contact us.

The effect of *Regina* on Preferential Rents

While the *Regina* court's review was limited to rent overcharge provisions, we believe the constitutional analysis they used is applicable to all provisions of the HSTPA with retroactive effect. There are many provisions of the HSTPA which appear to have some retroactive effect (IAIs, MCIs, and luxury-deregulation, to name a few) however for the purposes of this letter we are focusing specifically on preferential rents.

Preferential rents have long been an asset to rent-stabilized landlords because they allow for flexibility in fluid market conditions. Prior to the HSTPA, a properly offered preferential rent was freely revocable any time the lease came up for renewal, allowing landlords to adapt to evolving economic conditions and even to accommodate tenants who may be facing temporary financial hardship.

This flexibility was eliminated by Part E of the HSTPA which codified substantial changes to preferential rents. "Any tenant who is subject to a lease on or after the effective date of a chapter of the laws of two thousand nineteen which amended this subdivision, or is or was entitled to receive a renewal or vacancy lease on or after such date, upon renewal of such lease, the amount of rent for such housing accommodation that may be charged and paid shall be no more than the rent charged to and paid by the tenant prior to that renewal."

Thus, under the HSTPA, a landlord is no longer entitled to revoke a preferential rent previously given to a tenant, and any renewal leases offered after June 14, 2019 must be at the prior preferential rent plus applicable RGB increases. The HSTPA effectively renders any existing preferential rent a permanent preference for the life of a given tenancy. While the higher legal rent will be preserved and continue to increase, a landlord cannot charge the full legal rent unless a vacancy occurs.

The harsh retroactive effect of this statute is undeniable. For any landlord who offered a temporary preferential rent prior to June 14, 2019 with the expectation that it could be revoked at will, they have been statutorily deprived the benefit of their bargain and are now required to honor this preference as long as the tenant chooses to reside in the premises. This harsh consequence is even worse when combined with impotent succession standards and the elimination of vacancy increases because now, in some circumstances, it is possible that a preferential rent may be passed on between successive family members in perpetuity.

In light of this new case law, we believe that it would be unconstitutional to retroactively enforce the new HSTPA rules to temporary preferential rents offered prior to June 14, 2019. While *Regina* only expressly outlawed the retroactive enforcement of HSTPA overcharge regulations, and dealt exclusively with J-51 issues, we believe the analysis is also applicable to the new preferential rent rules because of the comparably harsh retroactive effect it has on landlords.

Accordingly, for any effected client who would like to consider revoking a preferential rent previously offered to a rent-stabilized tenant, we encourage you to review the below checklist and then reach out to us for further consultation:

Revoking a Preferential Rent under the HSTPA

- **The preference must have been properly offered in the first place**: This is a common pit-fall which trapped landlords even before the HSTPA was passed. In order to have the right to revoke a preference the landlord must have expressly reserved the right to do so when the preference was first offered. You must review the initial lease (or any lease that extends a preferential rent) and make sure that it specifically notes that a preferential rent was offered and may be revoked in the future. If your lease does not clearly indicate that a preferential rent was granted AND that that preference can later be removed, then this preference was likely irrevocable even before passage of the HSTPA.

- **The preference must have been properly offered for the first time prior before June 14, 2019**: The HSTPA was signed into law on June 14, 2019 and, even under *Regina*, continues to apply to all events occurring on or after that date. Thus, if you entered into a new lease with a preferential rent after 6/14/19 or offered an existing tenant a preferential rent for the first time after that date, the HSTPA will apply and you will not be entitled to revoke that preference for the lifetime of that tenancy.

- **If you offered a proper revocable preference prior to June 14, 2019, you must revoke it at the first opportunity or it will become permanent**: The premise of our argument, which has yet to be tested, is that the HSTPA should not be applied retroactively to preferential rents in effect prior to June 14, 2019. Thus, if a landlord wants the ability to revoke a preference in effect prior to the HSTPA, the landlord must revoke the preferential rent at the first lease renewal after June 14, 2019. If the Landlord voluntarily renews a preferential rent after June 14, 2019, they will likely be deemed to have "acquiesced" to the new rules and the preference is now permanent. *Note: If you renewed a preferential rent solely because you thought you were required to do so under the HSTPA, see below*.

- **If you renewed a preferential rent after June 14, 2019 solely because you relied on the retroactive intent of the HSTPA, you *MAY* still be able to revoke it**: As discussed above, Landlords must revoke the preferential rent the first time the lease is renewed after June 14, 2019 or the preference will likely be deemed permanent under the HSTPA. That being said, if you renewed a preferential rent after June 14, 2019 solely because you thought you were required to do so, you may still be able to revoke it provided you do so on the very next renewal lease. This argument is based on somewhat complex caselaw and will carry an extra layer of risk which should be carefully considered however, for some landlords, the potential upside is undeniable.

The above is only a brief summary of applicable considerations and we must stress that the revocability of preferential rents is highly variable and fact-specific. Improper removal of a preferential rent can subject landlords to liability for rent overcharges and treble damages and should be done cautiously. Moreover, while we are confident in our analysis, this legal theory has not been tested in court and remains subject to judicial challenge.