

## New York Court of Appeals Roundup: Rent Stabilization, Champerty, Lieutenant Governor Appointment

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In recent decisions, the Court of Appeals held that property owners cannot take advantage of luxury decontrol from rent stabilization during a period in which they took advantage of J-51 tax incentives, interpreted New York's champerty statute narrowly in a suit arising out of securitized mortgages, and rejected a challenge by certain state senators to Governor David Paterson's appointment of Richard Ravitch as lieutenant governor. We discuss these decisions below.

### Rent Decontrol

The Court in [Roberts v. Tishman Speyer Properties, L.P.](#), one of the most carefully watched real estate-related cases of the decade, decided that the current and former owners of the Stuyvesant Town and Peter Cooper Village apartment complexes in Manhattan were not entitled to take advantage of the luxury decontrol provisions of the Rent Stabilization Law (RSL) during the period in which they were receiving tax incentive benefits under New York City's J-51 program. The detailed dissent by Judge Susan Phillips Read, joined in by Judge Victoria A. Graffeo, together with the Court's rarely used format in cases of this kind, a per curiam four-judge majority opinion, suggests the ultimate result did not come easily. Chief Judge Jonathan Lippman took no part.

The city's J-51 tax incentive program, authorized by §489 of the Real Property Tax Law, allows property owners who complete qualifying projects to improve multiple dwellings to receive tax exemptions or abatements for a period of years. Here, defendant subsidiaries of Metropolitan Life Insurance Company, the builder and

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prior owner of the properties, applied for and received J-51 benefits starting in 1992. The properties, however, were built in the 1940s and were rent stabilized in 1974, long before the J-51 tax incentive program came into existence. MetLife sold the properties to the Tishman Speyer defendants for \$5.4 billion in late 2006, three months before the action was commenced.

Since entering the J-51 program in 1992, the owners of the properties received \$24.5 million in tax benefits that were scheduled to continue until 2017. In this potential class action lawsuit they face claims for repayment of alleged rent overcharges in the amount of \$215 million.

In 1993, in an effort to achieve what was seen as rent reform, the Legislature enacted the Rent Regulation Reform Act (RRRA). This legislation provided for decontrol of rent-stabilized apartments where an apartment was vacant and the regulated rent was \$2,000 or more per month or with respect to occupied apartments for which the regulated rent was \$2,000 or more per month and the combined annual income of the occupants exceeded \$250,000 per year (later reduced to \$175,000 per year). The RRRA as enacted provided that luxury decontrol would not apply to apartments that "became or become" subject to the Rent Stabilization Law "by virtue of" receiving J-51 benefits. Thereafter, in accordance with the RRRA, the owners began to charge market-rate rents for those units that they believed had been decontrolled, and continued to do so.

In 1996, the State Division of Housing and Community Renewal (DHCR), the agency where rental apartments in buildings receiving J-51 exemptions or abatements are required to be registered, issued an advisory opinion stating that participation in the J-51 program only precluded luxury decontrol where the receipt of J-51 benefits was "the sole reason" for the housing being subject to rent regulation.

DHCR in 2000 amended the Rent Stabilization Code to conform to that advisory opinion, and later published reaffirmations of its position in 2004 and 2007. As a result, there was no doubt where the administrative agency stood on this issue.

This putative class action was brought by a group of current and former residents in apartments at the properties who were charged rents in excess of rent stabilization levels while the owners were receiving J-51 tax benefits. In addition to

damages and attorney's fees, the complaint seeks a declaration that the apartments involved will remain rent stabilized until the tax benefits expire.

The trial court granted the defendants' motion to dismiss the complaint on essentially two grounds: (a) that RRRRA's exception to deregulation of accommodations that "became or become" subject to rent stabilization "by virtue of" receiving J-51 tax benefits did not include the properties because they had been rent stabilized since 1974, nearly two decades before MetLife first received J-51 benefits; and (b) the deference that should be shown to the clear position of DHCR as to its interpretation of the exclusionary language of the RRRRA.

The Appellate Division unanimously reversed, disagreeing with both grounds relied upon by the trial court, and granted the owners leave to appeal to the Court.

The Court agreed with the conclusions of the Appellate Division that building owners who receive J-51 tax benefits forfeit their right to luxury decontrol of accommodations even if their buildings were already subject to the RSL, and that DHCR's interpretations of the luxury control provision of the RRRRA were owed no deference. The Court also relied upon the legislative history of the RRRRA to support its interpretation of the statute.

In reaching its result, the Court took account of the asserted "dire financial consequences" to the defendants and "the New York City real estate industry," as argued by the owners and several amici and emphasized in the dissent, but declined to accept that as a reason to disregard what it saw as the "only correct interpretation of the statute."

It is likely there will be many additional chapters to this "book," as issues such as the retroactivity of the Court's interpretation of the RRRRA, class certification, the statute of limitations and other defenses, as suggested in the Court's decision, remain to be resolved.

#### Champerty

The Court discussed the intent and scope of New York's champerty statute in its unanimous opinion in [Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors Inc. Mortgage Pass-Through Certificates, Series 1999-C1 v. Love Funding Corp.](#)

It interpreted the statute narrowly, as applicable to the purchase of claims by a lawyer for the purpose of earning fees in prosecuting the claims. In answering a question of first impression, the Court stated that there is no prohibition against accepting, as part of a settlement, an assignor's right to recover its attorney's fees in the action being settled, even if the assignee might recover more than the amount for which he would have been willing to settle.

Paine Webber Real Estate Securities Inc. (referred to herein, along with its successor, UBS, as "Paine Webber") had entered into a Mortgage Loan Purchase Agreement (MLPA) with Love Funding Corporation. In exchange for a fee, Love originated loans and assigned them to Paine Webber. Pursuant to the MLPA, Love represented and warranted that the loans would not be in default when assigned, and agreed to indemnify Paine Webber for any liabilities and costs, including attorney's fees and expenses, arising from a breach of the MLPA.

Among the loans assigned to Paine Webber was the \$6.4 million "Arlington loan." Paine Webber, in turn, sold that loan and others to a Merrill Lynch-sponsored trust as part of a mortgage securitization transaction, making representations and warranties similar to those of Love under the MLPA. The trust later sued Paine Webber over 30 of the loans. It alleged, among other things, that the principals of the borrower had committed fraud in procuring the Arlington loan and therefore the loan was in default when Paine Webber sold it to the trust.

This litigation apparently was hard fought, as the trust incurred \$7 million in legal fees and Paine Webber incurred \$30 million. The parties settled the action, with the trust receiving \$19.4 million for the other loans at issue and, with respect to the Arlington loan, assignment of Paine Webber's rights under the MLPA.

The trust then sued Love for breach of its representation. It sought to recover not only the losses on the Arlington loan, but also Paine Webber's legal fees in defending itself against the trust's now-settled action.

The U.S. District Court for the Southern District of New York granted summary judgment to Love, holding the assignment void for champerty because, the court found, the trust had accepted it for the primary purpose of bringing a suit. On appeal, the Second Circuit certified questions to the Court of Appeals.<sup>1</sup>

Judge Eugene F. Pigott Jr.'s decision explained that §§488-489 of the Judiciary Law are more limited than the common law doctrine of champerty. The statute is aimed at preventing lawyers from acquiring claims for the purpose of making money from litigating them (although §488(2)(d) permits contingent fee arrangements). Courts therefore distinguish between acquiring claims to obtain costs and acquiring them to "protect an independent right of the assignee."

The Court stated that if the trust's purpose in taking the assignment was to enforce Paine Webber's rights, "then, as a matter of law, given that the Trust had a pre-existing proprietary interest in the loan, [the assignment] did not violate Judiciary Law §489(1)."

Love also challenged the trust's right to seek recovery of Paine Webber's legal fees. It pointed to the fact that Paine Webber's fees far eclipsed the \$10 million for which the trust had offered to settle its claim with Love. (In oral argument before the Court of Appeals, Paine Webber's counsel stated that the trust was seeking only \$300,000 in legal fees, those related to the Arlington loan.) The Court found no basis upon which to invalidate an assignment that, as part of a settlement, transferred either a right of indemnification for reasonable costs and fees in defending a past action or a right that has the potential for recovery of an amount larger than that for which the assignee would have been willing to settle its claim.

#### Lieutenant Governor

The New York State Legislature has at times been described by some as "dysfunctional." When its work came to a virtual standstill earlier this year, Mr. Paterson attempted to break the deadlock by filling the vacant office of lieutenant governor by appointment, something no other governor has done. In [Skelos v. Paterson](#), the Court ruled that the governor had acted within his power.

A lieutenant governor has limited duties, namely to preside over the Senate and cast a tie-breaking vote on certain procedural matters. In addition, the lieutenant stands in line to succeed the governor, followed by the temporary president of the Senate.

Former Governor Eliot Spitzer resigned in 2008. He was succeeded by Mr. Paterson as lieutenant governor. That position then remained vacant for over a year. When

the Senate became evenly divided between Democrats and Republicans, each party recognized a different temporary president of that body, a situation that both threw a cog in the wheel of legislative action and caused uncertainty over who would fill the office of governor should it become vacant.

On July 8, 2009, Mr. Paterson named former MTA Chairman Richard Ravitch as lieutenant governor. The following day, two state senators filed an action in Supreme Court, Nassau County, seeking a declaration that the appointment was unconstitutional. The court rejected the defendants' challenge to the senators' standing and preliminarily enjoined Mr. Ravitch from acting in the capacity of lieutenant governor. The Appellate Division, Second Department affirmed in a per curiam opinion.

In an decision by Chief Judge Jonathan Lippman handed down just two and one-half months after Mr. Ravitch's appointment, the Court of Appeals (4-3) reversed. Article XIII, §3 of the Constitution provides that the Legislature "shall provide for filling vacancies in office" and that a person "appointed to fill" a vacancy in an elected office may not hold the position beyond the next annual election.

The Legislature responded to its constitutional obligation to address the handling of vacancies in the Public Officers Law, which provides in part that if a vacancy in an elective office occurs "with no provision of law for filling the same, ...the governor shall appoint a person to execute the duties thereof until the vacancy shall be filled by an election." Public Officers Law §43. Article IV of the Constitution provides that the temporary president of the Senate shall "perform all the duties" of lieutenant governor in the event of a vacancy, and that a governor and lieutenant governor be elected by a single ballot in an election only to be held quadrennially (unless both offices are vacant, in which case they shall be filled in the next general election). N.Y. Constitution, Article IV, §§1, 6.

Plaintiffs argued that when properly interpreted, these constitutional and statutory provisions dictate that the office of lieutenant governor can only be filled in the next quadrennial election, and the duties of that office executed by the temporary president of the Senate in the interim.

The Court disagreed. It pointed out that such interpretation would leave the office vacant for an ex-tended period of time, contrary to the "main object" of Article III,

§3—to assure that vacancies are filled. The majority saw the Public Officers Law as complementary to Article III, §6, the latter addressing how a lieutenant governor's duties are to be performed until the office is filled by appointment pursuant to §43 of the law. The majority perhaps overstated the case in declaring that the Legislature by statute and constitutional amendment has "specified" that a vacancy in the lieutenant governor's office may be filled by gubernatorial appointment alone. Its invitation to the Legislature to revisit the issue may be accepted.

Judge Eugene F. Pigott, Jr. dissented, joined by Judges Victoria A. Graffeo and Robert S. Smith. The dissent construed the various constitutional provisions as mandating that a vacancy in the office of lieutenant governor remain until the next quadrennial election or, if the office of governor is also vacant, the next election.

In the event of a vacancy, Public Officers Law §43 only authorizes execution of a lieutenant governor's duties by the Senate's temporary president and does not confer upon the governor any right of appointment, Judge Pigott argued.

As to the issue of standing, because the public interest would be best served by an expeditious resolution of the dispute, the majority "assum[ed] without deciding" that the Senators had standing. The dissent viewed standing as a threshold issue that had to be resolved before the Court could reach the merits, but proceeded to conclude that the plaintiffs had standing because the governor's alleged overreaching directly affected sitting Senators.

Endnote:

1. The Court of Appeals found it unnecessary to answer one of the Second Circuit's questions, whether a challenged assignment is void only if the assignee's "sole" intent violated the Judiciary Law, or also if its "primary" intent violated the statute.