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Escalations and Rents—the Defensive Side of the Voluntary Payment Doctrine

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The voluntary payment doctrine has been long applied to prevent tenants from recovering payments made to the landlord which were tendered "voluntarily"—to wit, without dispute or inquiry—over a lengthy period of time. For example: a tenant tenders payment of real estate taxes to the landlord for over 10 years pursuant to what the tenant later claims to be an erroneous method of calculation, resulting in an overbilling. With this newfound knowledge, the tenant brings suit against the landlord to recover the amounts overpaid. By virtue of the voluntary payment doctrine, under this scenario, the tenant is, in essence, out of luck.[1]

The voluntary payment doctrine precludes the tenant from recovering those payments which it has voluntarily tendered, in the absence of fraud or mistake of fact. Likewise, as more fully discussed below, under this scenario, where the first overcharge occurred more than six years before the tenant commenced action, the applicable statute of limitations will bar the tenant's recovery of any of the overpaid sums—yes, even those overpayments made within the six years before commencement of the suit.

But what happens when the tenant does not seek recoupment, but rather stops (or decreases) future rent payments, arguing that the landlord incorrectly calculated the amounts due and that the tenant is entitled to offset future amounts by any "overpaid" sums? What if the tenant sua sponte determines the "correct" method of calculation and pays the rent/additional rent according to its own calculation? This article will address such defensive instances, where the landlord has charged (and tenant has paid) rent pursuant to a set method of calculation for an extended period of time, and the tenant belatedly contests same, arguing that, even if it is unable to recover the amounts already paid, it should be entitled to pay rent at a lower rate going forward, with a credit for the overpayments.

Offset

The tenant is not merely prevented from proactively collecting the overpaid amounts—the tenant will also be precluded from defensively using those overpaid amounts to offset other sums due under the lease. In other words, a commercial tenant cannot withhold rent on the basis that it is entitled to a credit for the voluntarily "overpaid" sums.

This was considered last year by the Appellate Division, First Department, in *Murray Hill Mews Owners Corp. v. Rio Restaurant Associates*,[2] wherein the landlord calculated the tenant's rent increases pursuant to a set method of calculation consistently over the course of eight years. After paying the increased rent without protest for those years, the tenant suddenly claimed that the increases were improperly calculated using a method which included the annual compounding of amounts charged, and refused to pay the increased rent going forward at the rate calculated by the landlord, and claimed an offset against the rents due.

The landlord then commenced a nonpayment proceeding against the tenant. The tenant argued that it was entitled to a credit against past due and future rent for the amounts which it claimed were overpaid or, at a minimum, that tenant was not bound by landlord's method of calculation going forward. The Civil Court held that the tenant was not entitled to offset future rent by the amounts it claimed to have overpaid. The court determined that the method of calculation utilized by the landlord was to be continued throughout the remainder of the lease, as not only was the lease unambiguous, but the course of conduct of the parties over a lengthy period of time (to wit, the voluntary payment doctrine) precluded same as tenant did not question or dispute the method of calculation.

Specifically, the Civil Court quoted from *Eighty Eight Bleecker Co. v. 88 Bleecker Street Owners, Inc.*,[3] that "[tenant's] 'marked lack of diligence in determining what its contractual rights were' demonstrates that the payments were voluntary and not made under mistake of law." The Appellate Division agreed with the Civil Court, stating, "when viewing the parties' course of conduct—including respondent's consistent payment for over eight years, without protest, of rent increases based on a compounded fixed rent figure, and its renegotiation of the renewal lease on the same terms as the original lease—it is clear that petitioner's construction of the

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escalation clause comports with the parties' intent. Respondent's affirmative defense that it was overcharged is undermined by its admitted receipt of at least some of the rent notices and its long term acquiescence in petitioners' interpretation of the escalation clause."[4]

An arguably harsher result based on the voluntary payment doctrine was reached by the Second Department in *Gimbel Bros. v. Brook Shopping Centers*.[5] In *Gimbel Bros.*, the tenant sought a judicial declaration that it was not required to pay "Sunday Charges" (charges imposed on tenant for each Sunday which it opened), arguing that these Sunday charges were not required by the lease, although the landlord had billed (and tenant had paid) such charges for almost two years. The tenant further sought restitution for the Sunday charges paid, arguing that it was operating under a mistake of fact when it tendered those fees. The court agreed that the tenant was not obligated to pay such Sunday charges, finding that there was no provision in the lease requiring the payment of same.

The court nonetheless concluded that the tenant could not recover the past amounts which it had incorrectly paid. Specifically, the court found that the tenant "made the subject payments voluntarily, as a matter of convenience, without having made any effort to learn what its legal obligations were," and therefore was entitled to neither restitution, nor to offset the tendered amounts against future rent. However, as there was no provision in the lease for such Sunday charges, the tenant was not required to pay any such charges going forward.[6]

Thus, New York courts have held that the voluntary payment doctrine precludes a tenant from disputing voluntarily paid sums, from either an offensive or a defensive position. The rule is clear: where a tenant pays rents without protest or inquiry, the tenant will not be able to recover such rent affirmatively or as an offset against future amounts due.

Statute of Limitations

The voluntary payment doctrine is not the only bar to prevent a tenant from recouping voluntarily paid sums, or from altering a method of calculation after acquiescing to it for years. The statute of limitations also serves to protect the "overbilling" party from such situations, provided that the contested method of calculation was consistently employed by the landlord, and that more than six years have passed since the first instance of consistent overcharge.

Specifically, overpayments of rent are subject to the statute of limitations prescribed in CPLR §213, which requires any recovery actions to be commenced within six years. Many practitioners believe that this means that the tenant would be limited to recovering only those amounts that have been paid in the six years immediately prior to the commencement of the action. This would mean, for example, that if a tenant is claiming that it has been overbilled for 10 years, the tenant will be able to recover the overcharged amounts for the later six years falling within the statute of limitations. Alternatively, many practitioners believe that the statute of limitations commences with each "new" overcharge.

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Neither of these presumptions is correct. Rather, the statute of limitations begins to run with the first overcharge; if the first overcharge occurred more than six years prior to the commencement of the action and if the same method of computation was consistently used by the landlord during that period, the tenant will be barred from recovering any of the allegedly overpaid sums for the full 10 years.[7]

The leading case on the statute of limitations serving to bar claims of overcharge is *Goldman Copeland Assocs. v. Goodstein Bros. & Co.*[8] In *Goldman*, the tenant was provided with yearly porter wage rent escalation statements, and paid the amounts due therein for nearly 12 years without protest. After tendering such payments for this extended period of time, the tenant determined that the method of calculating the increases employed by the landlord was incorrect, and that the tenant had been overbilled. The tenant sued the landlord, seeking to recover the overpaid amounts.

The court found that, "since [the rent] statements consistently used the same formula in determining the escalation, the tenant's overcharge claim accrued upon its receipt of the first statement almost 12 years before it commenced [the] action. At that time, it had all of the information it needed to contest the manner in which the landlord computed the escalation." Thus, the tenant's entire claim was barred by the statute of limitations.

The Supreme Court, New York County, further considered this issue in *Kramer Levin Naftalis & Frankel v. Metropolitan 919 3rd Ave.*,[9] wherein the tenant argued that it was entitled to a rent credit based on improperly calculated real estate tax escalations. The court found that, under the terms of the lease, the tenant would ordinarily be entitled to a credit. However, as the first alleged overcharge occurred more than six years prior to the commencement of the action, the tenant was barred from seeking any rent credit based on those overpaid sums.

More recently, this was discussed in *Fisk Building Assoc. v. Dennelisse Corp.*,[10] wherein the commercial tenant failed to pay additional rent, claiming it had been overbilled, despite having paid such additional rent, as calculated by the landlord, for over seven years without dispute. The tenant vacated the leased premises at the expiration of the lease without paying the additional rent, resulting in the landlord's plenary action to recover the outstanding sums. The court granted the landlord's motion for summary judgment, and found that the tenant could not challenge the landlord's method of computation, stating that both the voluntary payment doctrine and the statute of limitations barred the tenant's claim of entitlement to an offset.

Mistakes of Fact

As stated above, the voluntary payment doctrine only applies in the absence of fraud or mistake of fact. But what qualifies as a "mistake of fact"? The instances in which courts have found the voluntary payment doctrine inapplicable by virtue of a mistake of fact are few and far between, and do not present any hard-line rules.

Notably, a claim by the tenant that it unilaterally made an error and would not have otherwise tendered the payments is insufficient alone to qualify as a "mistake of fact." Thus, an argument based on the tenant's mistaken assumption as to what the

lease provided, or the amounts that were being charged, will not be entertained. For example, in *Eighty Eight Bleecker Co.*, the First Department considered a case where the tenant had paid real estate tax escalations for over 20 years without dispute or inquiry, and then discovered that the landlord had been charging such escalations based on the gross taxes due, rather than on the taxes actually imposed on the property. The tenant commenced an action against the landlord to recover the overpaid amounts arguing, inter alia, mistake of fact.

The court rejected this argument, and found that the voluntary payment doctrine precluded the tenant from recovery, stating, "There is no evidence that plaintiff, during the lengthy period of the initial term of the lease, ever reviewed the rent provisions and compared them to the rent bills it was receiving from defendant's former managing agent. It needed only to check the amount of the base rent set forth in the lease to determine if overcharges were indeed being made. Since plaintiff paid these charges 'without protest or even inquiry, and [was] not laboring under any material mistake of fact when [it] did so,' its claim as to the basic rent overcharge is barred by the voluntary payment doctrine. Plaintiff was not acting under a mistake of fact…" Thus, in sum, where a tenant had the tools necessary to determine whether it was being overcharged, but chooses not to use them, no mistake of fact will be found.

Likewise, in *Gimbel Bros.*, where it was determined that the tenant made the contested payments as a matter of convenience, the Second Department rejected tenant's claim of mistake of fact. In so doing, the court noted that the charges at issue were clearly delineated on each of the invoices sent to the tenant, and that a conscious decision was made to continue paying the contested charges while the matter was being investigated. The court thus stated, "Under all of these circumstances, we conclude the trial court correctly found that no mistake of fact had been made."

Therefore, the rule applied by the courts as to mistake of fact appears to center on what the tenant knew, or should have known, with harsh results where the tenant fails to take any action to resolve any uncertainties prior to payment.[11]

Notwithstanding the above, the courts will not require the tenant to, in essence, pay for nothing, even if those payments have been tendered "voluntarily." Such a situation was considered by the First Department in *NHS National Health Services v. Kaufman*,[12] where the tenant sued its landlord, seeking recovery of rent mistakenly paid by the tenant after it vacated a portion of its space. Specifically, the tenant had executed a lease for multiple units, the charges for which were itemized in rent billings. The tenant vacated one of the units, and the landlord re-let same, but left the unit on the master lease and continued to charge tenant the full lease rent. Once the tenant discovered that it was paying rent for space which it was no longer occupying (claiming confusion as the rent invoices were no longer itemized), the tenant sought recovery of the paid amounts.

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The court found that these payments, even if negligently made, constituted a "mistake of fact," and granted the tenant summary judgment, stating, "We have applied equitable principles akin to the doctrine of unjust enrichment to the situation where a payor overpays money to payee, even if negligently so, under a mistake of fact."

Most recently, this issue was revisited by the First Department in *Daval-Ogden v. Highbridge House Ogden*[13] In *Daval-Ogden*, the tenant tendered the first month's rent and a security deposit for use of a commercial space, and was later advised that it could not occupy that space, as there was a conflicting lease entitling another tenant to occupy it. The tenant commenced an action against the landlord to, inter alia, recover the security deposit and first month's rent, and the landlord asserted the voluntary payment doctrine as a defense. The First Department rejected the use of the voluntary payment doctrine, finding that the tenant was operating under a mistake of fact, as it was unaware that another tenant was entitled to possession of the space.

Thus, the "mistake of fact" determination appears to rest on equitable considerations, and knowledge on the part of the landlord as to whether the tenant was being improperly charged, as well as what the tenant knew or could/should have ascertained. While the voluntary payment doctrine will bar the recovery of payments made without dispute and with full knowledge of the facts, the courts are not so harsh as to hold tenants to payments made under a mistake of a material fact, where the true state of facts was known to the landlord.

Conclusion

The lesson is clear: Tenants must be diligent in keeping informed about the payments that they are tendering to their landlord. Invoices should not just get paid. The calculations, increases, percentage amounts are like measuring formulae which must be analyzed against the lease provisions. And, for the landlord's part, landlords should verify that they are, indeed, charging the correct rent, and ensure that they are properly documenting the consistency of the charges, and the tenant's knowledge of same. Or, just hope six years pass very quickly.

1. Such a scenario was recently discussed in the article "Payments Made In Error: The Voluntary Payment Doctrine," New York Law Journal, Jan. 9, 2013, wherein the authors detail the application of the offensive side of the voluntary payment doctrine.
2. 26Misc.3d1224A(Civ.Ct.N.Y.Co.2010)rev'd30Misc.3d129A (App.Term 1st Dept. 2010) rev'd 92 A.D.3d 453 (1st Dept. 2012).
3. 34 A.D.3d 244 (1st Dept. 2006).
4. Id. at 453.
5. 118 A.D.2d 532 (2d Dept. 1986).
6. See Menachem J. Kastner, "Keeping Up With Escalation Clauses," New York Law Journal, July 12, 2012.
7. See *Goldman Copeland Assocs. v. Goodstein Bros. & Co.*, 268 A.D.2d 370 (1st Dept. 2000).
8. Id.
9. 6 Misc.3d 796 (Sup. Ct. N.Y. Co. 2004).
10. 2010 NY Slip Op 32269 (Sup. Ct. N.Y. Co. 2010).
11. See also *Rite Aid of New York v. Chalfonte Realty*, 2013 NY Slip Op. 02349 (1st Dept. April 9, 2013), where the court concluded that the *Goldman Copeland* statute of limitations bar would not apply where the tenant adequately alleged that it did not possess the documentary information necessary to determine whether it had been overcharged under the lease provisions relating to real estate taxes. The court emphasized that, where a tenant is able to demonstrate that it could not have made the appropriate calculations based on what the landlord had supplied, then the strict application of the statute of limitation would not apply. Furthermore, the court found that the mistake of fact and law defense to the Voluntary Payment Doctrine would apply where the underlying documentation supplied by the landlord to the tenant evidencing the basis for the increase in the real estate taxes was inconclusive. Accordingly, neither the statute of limitations nor the Voluntary Payment Doctrine barred tenant's challenge of the increase in real estate taxes.
12. 250 A.D.2d 528 (1st Dept. 1998).
13. 2013 NY Slip Op 00703 (1st Dept. 2013).