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'Regina' and Fraud: A Much Needed Clarification

In this follow up to last month's article discussing 'Regina Metro v. New York State Div. of Hous. & Community Renewal' in relation to its holding concerning the unconstitutional retroactive application of Part F of the HSTPA, this article focuses on another feature of that decision—fraud—which didn't get as much coverage but nonetheless may be just as impactful.

By **Nativ Winiarsky** | July 02, 2020

Nativ Winiarsky. Courtesy photo

In an article published on these pages on June 23, 2020 entitled "The Court of Appeals Ruling in *Regina* and its Potential Impact Upon Settled Claims" I wrote about the ground breaking 4-3 decision of *Regina Metro. Co., LLC v. New York State Div. of Hous. & Community Renewal*, 2020 N.Y. LEXIS 779, 2020 NY Slip Op 02127 (April 2, 2020) (*Regina*)[1] which among other things found that the retroactive application of Part F of the Housing Stability and Tenant Protection Act (HSTPA) was unconstitutional on due process grounds and the

ramifications of such a holding on the enforcement of settled claims. The implications of that holding which struck down, as violative of substantive due process, a remedial statute duly enacted by the Legislature, will reverberate downward and throughout our legal system and will be felt for years to come.

But there was another feature of the *Regina* decision which didn't get as much coverage but nonetheless may be just as impactful, which is the court's discussion of the issue of fraud.

Prior to the enactment of the HSTPA, a tenant's rent overcharge claim was limited to a four-year lookback period and statute of limitations ("four-year interrelated rule") as far as filing of overcharge claims, retention of records, establishment of the base date rent, and calculation of rental overcharges. There was no statutory exception to the four-year interrelated rule.

Beginning in 2005, there were four decisions that were issued by the Court of Appeals confirming that reviewing rental history outside the four-year lookback period was inappropriate for purposes of calculating an overcharge. However, the court recognized a limited common-law exception to this otherwise categorical evidentiary bar, permitting tenants to use such evidence only to prove that the owner engaged in a fraudulent scheme to deregulate a unit. Those cases were respectively, *Thornton v. Baron*, 5 N.Y.3d 175, 179, 800 N.Y.S.2d 118, 120, 833 N.E.2d 261, 263 (2005) (*Thornton*); *Matter of Grimm v. State of New York Div. of Hous. & Community Renewal Off. of Rent Admin.*, 15 N.Y.3d 358, 912 N.Y.S.2d 491, 938 N.E.2d 924 (2010) (*Grimm*); *Matter of Boyd v. New York State Div. of Hous. & Community Renewal*, 23 N.Y.3d 999, 992 N.Y.S.2d 764, 16 N.E.3d 1243 (2014) (*Boyd*); and *Conason v. Megan Holding, LLC*, 25 N.Y.3d 1, 6 N.Y.S.3d 206, 29 N.E.3d 215 (2015) (*Conason*).

These four decisions provided valuable guidance as to what both constitutes a fraudulent scheme used to deregulate an apartment and a colorable claim of fraud. Nevertheless, in the past 15 years, courts have varied widely as far as what they have determined to be a colorable claim of fraud, what is an actual fraudulent scheme used to deregulate an apartment, and what is the base date rent if the rent charged on such base date rent is found to be unreliable (i.e., an overcharge).

Now, in *Regina*, the Court of Appeals has addressed these varied applications by insisting that courts revert to using the common law fraud definition in its application to the four-year interrelated rule. *Regina* has now clarified that in order to utilize the "fraud" exception to the four-year interrelated rule, the tenant must meet the criteria of a common law fraud claim whereby a fictitious (i.e., fraudulent) rent event is manufactured to artificially inflate the rent history to deregulate an apartment thereby corrupting the reliability of the base date rent.

Thornton and *Conason* are the only two (2) decisions cited by *Regina* as having properly found that a rent event was both fictitious (i.e., never existed or as if it never existed) and used to artificially deregulate an apartment. In both cases, the base date rent event's connection to a reliable rent event was severed to the point that only a default formula was available to determine the base date rent, because in essence the true base date rent event never existed since the artificially inflated rent was entirely fabricated and had no basis in reality.

For example, in *Thornton* "the owner engaged in an egregious, fraudulent scheme to remove apartments from stabilization by conspiring with tenants, who shared in the illegal profits, by falsely agreeing the apartment was not being used as a primary residence (and utilizing the courts as a tool to obtain false declarations to that effect) to rent at market rates and then sublease at even higher rates. For overcharge calculation purposes, the court acknowledged the preclusive effect of the four-year lookback rule, deeming the last regulated rent charged before that period to be 'of no relevance' (*id.* at 180). The court held that the legal rent should be based on a "default formula," otherwise reserved for cases where there are no reliable rent records, setting the base date rent as 'the lowest rent charged for a rent-stabilized apartment with the same number of rooms in the same building on the relevant base date' (*id.* at 179-181 and n 1)." *Regina*, *supra*, *11-12

Similarly in *Conason*, "[w]e confirmed this procedure in *Conason*, where the owner created a fictitious tenant and fictitious renovation to justify a rent increase." *Regina*, *supra*, at *12.

Thus in both *Thornton* and *Conason*, the Court of Appeals was faced with a nonexistent tenant and nonexistent improvements (i.e., nonexistent rental events) concocted out of thin air and specifically used for the sole purposes of falsely deregulating an apartment. Acknowledging that the apartment's prior rental history in both histories could not be examined since they were predicated upon pretended facts, the stabilized rent before the fraudulent scheme was "of no relevance," mandating use of the default formula due to the unreliability of the rent history.

In *Grimm*, "[c]onsistent with *Thornton*, we directed that, if review of the rental history revealed such a fraudulent scheme, the default formula should be used to calculate any resulting overcharge." *Regina*, *supra* at *12. In *Boyd*, the Court of Appeals "reject[ed] a challenge to DHCR's use of the rent actually charged four years prior to filing of the claim to calculate an overcharge in the absence of fraud, [which] provided further clarification that the four-year lookback rule generally precluded review of rental history outside that period." *Regina*, *supra*, at *12-13.

Both *Grimm* and *Boyd* made clear that a court is precluded from looking back beyond four years if the only allegation is one of an overcharge. More to the point, it doesn't even matter if the overcharge was intentional or not because if the overcharge was unintentional, the tenant simply gets the overcharges refunded and if it was intentional, the overcharge is trebled which is the sole remedy. But clearly even an intentional overcharge is not fraud absent a fabricated event which is why there exists the remedy of treble damages and a separate independent remedy of the application of a default formula as used in *Thornton* and *Conason* and denied use in *Boyd*.

Given the misapplication of the law by various courts, the above proposition may sound in some way startling but one need look no further than the language again employed by the Court of Appeals in *Regina*. First, the court in *Regina* makes it clear that every overcharge is illegal. "In every overcharge case, the rent charged was, by definition, illegally inflated — otherwise there would be no overcharge." *Regina*, *supra*, at *19. However, just because the landlord charged an illegal and inflated rent, wilfully or not, does not allow the tenant to go beyond the four-year look back period. As stated in *Regina*:

> Prior to the HSTPA, nothing in the rent stabilization scheme suggested that where an unrecoverable overcharge occurred before the base date, thus resulting in a higher base date rent, the four-year lookback rule operated differently. To the contrary, the limitations provisions —in order to promote repose—precluded consideration of overcharges prior to the recovery period (former RSL § 26-516[a][2]; former CPLR 213-a), and it is clear from *Boyd* that use of a potentially inflated base date rent, flowing from an overcharge predating the limitations and lookback period, was proper in the absence of fraud. (Emphasis added)

Regina, *supra*, at *19

In the absence of fraud, an intentionally-inflated illegal rent still does not warrant going beyond the four-year lookback rule. This is exactly why in *Regina*, where the court was faced with four landlords who used an improperly inflated illegal deregulated market rent, the use of that illegal rent still just amounted to an overcharge (which may potentially be trebled) but that did not allow for use of the default formula or for looking back beyond the four-year lookback period.

As further stated in *Regina*, "the RSL makes no such distinction, and there is no indication that, under the pre-HSTPA law, an overcharge resulting from improper (but non-fraudulent) luxury deregulation warranted anything but the application of the standard lookback provisions." *Id* at *19-20. Here again the Court of Appeals makes clear that it does not matter how the rent was inflated; whether it was through vacancy decontrol, incorrect vacancy or guideline increase, or inflated costs related to improvements. The tenant has

his/her overcharge claim (which may be trebled) but the rent charged four years prior to the interposition of the claim still remains the legal regulated rent. Only when the rent four years prior to the interposition of the claim is a complete fabricated event and such rent is wholly unreliable can the concept of repose be ignored and use of the default formula be employed.

The Appellate Division of the First Department has recently issued a decision entitled *Corcoran v. Narrows Bayview Co., LLC*, 2020 N.Y. App. Div. LEXIS 3176, 2020 NY Slip Op 03061 (1st Dept. 2020) (*Corcoran*) which further strengthens the point that the default methodology is not used except in cases of a fabricated event. In that case, the Appellate Division found that the landlord a) did not give notice to the tenants of certain J-51 tax benefits which would make it illegal to deregulate a unit, b) issued leases representing the units as not being subject to rent regulation and failed to include rent stabilization riders; c) filed erroneous registrations improperly claiming the units to be exempt from regulations; d) removed the unit from rent stabilization; and e) undeniably overcharged the tenant. Yet despite same, the Appellate Division still ruled, citing to *Regina*, that that the plaintiff-tenants were precluded from looking back beyond the four year prior to the interposition of the complaint since the landlord did not engage in a fraudulent scheme.

The Appellate Division's finding in *Corcoran* was inescapable in view of *Regina* since *Regina* was insistent that concealing an apartment's regulated status (*i.e.*, offering fair market leases, renewals without stabilized riders, inflated increases, and falsely registering a rent stabilized unit as exempt) is not inherently a fraudulent scheme to deregulate allowing use of a default methodology since, unlike the cases in *Thornton* and *Conason*, these cases are generally devoid of some fabricated rental event like an invented lease or tenant and therefore there is no wholly fictional rent event which forever severs the link of reliability that tethers the base date rent from pre-base date rents.

While no one is underestimating the impact of *Regina* in relation to its holding concerning the unconstitutional retroactive application of Part F of the HSTPA, practitioners should pay equal attention to *Regina's* thorough analysis of fraud and the court's clear misgivings with the manner in which it was previously applied.

ENDNOTE:

[1] This author argued *Raden v. W7879*, before the Court of Appeals which was one of the other three cases argued with *Regina* and decided in conjunction with *Regina* in one consolidated decision.

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