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Retroactively Redefining 'Fraud': The Chapter Amendments

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In our August 2023 article, we discussed how the New York State Legislature had just passed a controversial bill, Assembly Bill A-6216-B and Senate Bill S-2980-C (the "bill"), on the last day of the legislative session in June 2023. Part B of the bill was particularly problematic on its face because, in 2023, it purported to retroactively redefine the standard for establishing the "fraud exception" to the four-year statute of limitations and four-year "lookback rule" for rent overcharge claims under the "pre-HSTPA" law.

This law is only applicable to conduct occurring *prior* to June 14, 2019. The "fraud exception" effectively provides an exception to the entire "pre-HSTPA" statutory scheme for determining rent overcharge claims.

Thus, in 2023, the bill sought to amend the law applying to conduct occurring prior to June 2019, raising substantial questions about the bill's constitutionality and whether it would be signed into law by the governor.

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At the time of the prior article, the bill had not yet been presented to the governor. This article provides an update on the status of the bill, and the significant changes to the original text of Part B of the bill that are expected to be passed by the Legislature soon using "chapter amendments."

Despite being passed by the Senate on June 20, 2023, the bill was not presented to Governor Kathy Hochul *for more than five months*, leaving the industry unsure and speculating as to the bill's fate. On Dec. 22, 2023, however, more than six months after the Legislature passed the bill, Governor Hochul signed the bill into law, but only after negotiating significant

"chapter amendments" to the bill with the Legislature, including substantial changes to Part B of the bill.

"Chapter amendments" are changes to the text of a bill that are negotiated by the governor and the Legislature *after* the bill is already passed by the Legislature. The Legislature then agrees to introduce and pass the negotiated changes as a new bill in the next legislative session in exchange for the governor agreeing to sign the current bill into law now.

Chapter amendments can be minor, technical fixes or substantial changes to the substantive law passed by the Legislature. Therefore, they provide a mechanism for the governor to entirely change a bill as passed by the Legislature, without vetoing the bill or causing the Legislature to start over.

While the intention of the chapter amendments is to "define clearly" the "fraud exception," they seemingly do the opposite, eliminating the bright-line rule and leaving it to the courts to assess whether the totality of the circumstances "indicate" that an owner committed a fraudulent scheme to deregulate.

Rather than vetoing the bill, the governor can negotiate and agree upon "chapter amendments" with the Legislature to be introduced and passed in the next legislative session. However, the negotiated chapter amendments do not take effect until they are actually passed by the Legislature and signed into law. Therefore, adding to the confusion, when signed by the governor, the bill as written actually becomes the law until the chapter amendments are passed, leaving the applicable law

in a state of limbo, particularly when the chapter amendments substantially change the bill, as here.

To understand the impact of Part B of the bill, and the changes negotiated via chapter amendments, some background is required. On June 14, 2019, the New York State Legislature effected a monumental overhaul of the rent laws by enacting the Housing Stability Tenant Protection Act of 2019 (the "HSTPA").

However, in April 2020, in *Matter of Regina Metro. Co., LLC v. DHCR*, 35 NY3d 332 (2020) ("*Regina*"), the New York State Court of Appeals held that rent overcharge claims that are based on a landlord's conduct that occurred prior to June 14, 2019 must be determined under the laws existing at the time of the conduct, the "pre-HSTPA law."

The court's reasoning was straightforward—retroactive application of new laws to conduct that occurred before the new laws existed would be unconstitutional, particularly because the prior laws provided landlords with "clear repose" for conduct that had occurred more than four years before a rent overcharge claim, via the four-year statute of limitations and look-back rule.

Under pre-HSTPA law, rent overcharge claims were subject to a strict four-year statute of limitations and four-year "lookback rule." Pre-HSTPA law provided that a tenant must bring a rent overcharge claim within four years of the first overcharge alleged or else their claim was time-barred, and that a tenant could not challenge their rent more than four years after a landlord registered it with DHCR (the four-year statute of limitations).

Pre-HSTPA law further provided that, when a tenant commenced a rent overcharge claim, the Court could not "lookback" earlier than the rent registered or actually charged four years before the tenant commenced the rent overcharge claim, known as "the base date," in order to determine the legal rent (the four-year lookback rule). This statutory scheme provided landlords with repose from liability for stale conduct that occurred more than four years ago, unless there was "fraud."

Many rent overcharge cases that are still being commenced and/or litigated today, including several class actions, concern conduct that occurred prior to June 14, 2019, and therefore, are governed by pre-HSTPA law.

The only exception to the pre-HSTPA statute of limitations and lookback rule is known as the "fraudulent deregulation scheme" exception, or "fraud exception," for short. The "fraud exception" provides that, where a tenant makes a "colorable claim of fraud" by producing evidence of a landlord's "fraudulent scheme to deregulate" an apartment that taints the reliability of the rent on the base date, then the court *can* review that apartment's rental history beyond the four-year lookback period to determine if the landlord had engaged in a fraudulent scheme to deregulate, and in cases of fraud, a tenant *can* recover overcharges for an otherwise time-barred claim.

If, upon looking back, the court finds that a landlord engaged in a "fraudulent scheme to deregulate an apartment" that tainted the reliability of the rent on the base date, then the Court (or DHCR) must use DHCR's punitive "default formula" to determine the legal rent, which generally drastically reduces a tenant's rent and results in substantial overcharge damages. Therefore, what elements are required for a tenant to establish the "fraud exception" is of the utmost importance.

In *Regina*, the Court of Appeals held that establishing "fraud" for purposes of establishing the "fraud exception" to pre-HSTPA law is no different than any other context, holding that the "fraud exception" requires a tenant to establish the elements of common law fraud, explaining: "Fraud consists of "evidence [of] a representation of material fact, falsity, scienter, reliance and injury."

Indeed, even as codified, the exception required a "fraudulent scheme to deregulate," which necessarily requires fraud. This standard finally provided courts with a bright-line rule for assessing and applying the "fraud exception"—simply, the fraud exception required fraud.

After the Court of Appeals decided *Regina*, New York State Supreme Courts and Appellate Courts began to consistently apply this common law fraud standard to assess what elements a tenant must prove to establish fraud as an exception to the pre-HSTPA law. However, *years* after the courts began to consistently apply the standard concerning the elements that a tenant must prove to establish the "fraud exception" to the "pre-HSTPA" law, the Legislature passed the bill in June 2023 to retroactively "define clearly" the standard for establishing the "fraud exception" to pre-HSTPA law, stating that the Court of Appeals had it wrong.

As stated in the legislative findings of the bill, "in light of court decisions…including *Regina Metro v. DHCR*, it is public policy that the legislature define clearly the scope of the fraud exception to the pre-HSTPA four-year rule for calculating rents which remains unsettled and the subject of litigation where courts have diverged from the controlling authority…to impose a common law fraud standard that is…inconsistent with the intent of the legislature…" The bill continued, "it is therefore public policy that the legislature codify, without expanding or reducing the liability of landlords under pre-HSTPA law, the standard for applying that exception." Yet, this fraud exception has existed since at least 2005, so "defining" it in 2023 is problematic.

The bill, as passed by the Legislature, states:

> "With respect to the calculation of legal rents for the period either prior to or subsequent to June 14, 2019, *an owner shall be deemed to have committed fraud if the owner shall have committed a material breach of any duty, arising under statutory, administrative or common law,* to disclose truthfully to any tenant, government agency or judicial or administrative tribunal, the rent, regulatory status, or lease information, for purposes of claiming an unlawful rent or claiming to have deregulated an apartment, *whether or not the owner's conduct would be considered fraud under the common law, and whether or not a complaining tenant specifically relied on untruthful or misleading statements in registrations, leases, or other documents*

However, this standard effectively deems *any* violation of any duty to automatically be fraud, even if the elements of fraud are not established, thereby providing an exception to the pre-HSTPA statute of limitations and lookback rule in *every* case.

As already recognized by the Court of Appeals in *Regina*, "an exception predicated on the fact that the base date rent was higher than what would have been permitted under the RSL…would swallow the four-year lookback rule. In every overcharge case, the rent charged was, by definition, illegally inflated—otherwise there would be no overcharge." In effect, this would retroactively eliminate the entire pre-HSTPA scheme, which is exactly the result that the Court of Appeals held to be unconstitutional in *Regina*.

Apparently, the governor agreed that Part B of the bill, as passed by the Legislature, was problematic, as predicted in our prior article. Therefore, before signing the bill into law, the governor negotiated chapter amendments with the Legislature, which *entirely* changed the text of Part B, eliminating the above language.

The "chapter amendments" have now been introduced in the next legislative session as Assembly Bill A08506. In the chapter amendments, the above quoted text from Part B is *entirely* deleted, and replaced with the following:

"Section 2 of part B of a chapter of the laws of 2023 relating to defining clearly the scope of the fraud exception to the pre-HSTPA four-year rule for calculating rents, as proposed in legislative bills numbers S. 2980-C and A. 6216-B, is amended, and a new section 2-a is added to read as follows:

> *When a colorable claim that an owner has engaged in a fraudulent scheme to deregulate a unit is properly raised as part of a proceeding…a court of competent jurisdiction* or the state division of housing and community renewal *shall issue a determination as to whether the owner knowingly engaged in such fraudulent*

scheme after a consideration of the totality of the circumstances. In making such determination, the court or the division shall consider all of the relevant facts and all applicable statutory and regulatory law and controlling authorities, *provided that there need not be a finding that all of the elements of common law fraud, including evidence of a misrepresentation of material fact, falsity, scienter, reliance and injury, were satisfied in order to make a determination that a fraudulent scheme to deregulate a unit was committed if the totality of the circumstances nonetheless indicate that such fraudulent scheme to deregulate a unit was committed*."

Therefore, if and when the chapter amendments are passed, Part B of the bill will no longer deem any violation of any duty to automatically constitute fraud, which is a step in the right direction (although, until passed, Part B as originally written is now the law).

Instead, the chapter amendments will now require a court to review "the totality of the circumstances" to determine whether a landlord "knowingly engaged" in a fraudulent scheme to deregulate. However, the chapter amendments expressly state "there need not be a finding that all of the elements of common law fraud, including evidence of a misrepresentation of material fact, falsity, scienter, reliance and injury, were satisfied," rejecting the Court of Appeals' straightforward holding in *Regina* that the "fraud exception" to the pre-HSTPA law requires actual fraud.

However, while rejecting this common law fraud standard, critically, the chapter amendments negotiated by the governor do not state or provide any guidance as to what elements *do* need to be satisfied to meet fraud standard under pre-HSTPA law, leaving it entirely undefined, again.

Rather, the chapter amendments merely provide that the "totality of the circumstances" must "indicate" that a fraudulent scheme to deregulate a unit was knowingly committed, without providing any further guidance or clarification.

This purportedly "clearly defined" standard for establishing the "fraud exception" under pre-HSTPA law is noticeably ambiguous and imprecise, sending the law back into a state of uncertainty and inconsistency, which the common law fraud standard had eliminated.

The bill, and the chapter amendments, will likely face the same legal challenges that parts of the HSTPA failed to overcome, because they retroactively "define" the standard for what is required to establish an exception to the entire pre-HSTPA statutory scheme. However, because the Legislature is purporting only to clarify prior law, the outcome of such legal challenges remains unclear.

What is clear is that the much-needed consistency that was finally emerging in pre-HSTPA "fraud" cases will again fall to confusion, and more litigation. While the intention of the chapter amendments is to "define clearly" the "fraud exception," they seemingly do the opposite, eliminating the bright-line rule and leaving it to the courts to assess whether the totality of the circumstances "indicate" that an owner committed a fraudulent scheme to deregulate.