

Real Estate Trends

LANDLORD-TENANT LAW

The ‘Fraud Exception’ Requires Fraud

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Just when New York courts were beginning to consistently apply the law concerning the elements that a tenant must prove to establish the “fraud exception” to the “pre-HSTPA” four-year statute of limitations and lookback rule for rent overcharge claims, the Legislature, in reaction to recent court decisions, has made a belated effort to retroactively redefine “fraud” in the context of pre-HSTPA claims, passing a bill that would effectively deem any past violation of any law or duty by a landlord to constitute fraud.

On June 20, 2023, the final day of the legislative session, the New York State Assembly passed a controversial bill, already passed by the Senate on June 9, 2023, which, among other things, purports to “clearly define the scope of the fraud exception to the pre-HSTPA four-year rule for calculating rents,” “in light of court decisions arising under the Housing Stability and Tenant Protection Act of 2019 (HSTPA), including *Regina Metro v. DHCR*.”



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The bill will, eventually, be presented to the Governor to either sign or veto. If signed, it will likely face the same legal challenges that curbed the retroactivity of parts of the HSTPA, and will add more confusion to the landscape, which was finally enjoying some clarity and consistency.

The recent court decisions to which the bill refers began with *Matter of Regina Metro. Co., LLC v. DHCR*, 35 NY3d 332 (2020) (“*Regina*”), and culminated with *Casey v Whitehouse Estates, Inc.*, 39 NY3d 1104 (2023), at the Court of Appeals, and *Burrows v 75-25 153rd Street, LLC*, 215 AD3d 105 (1st Dept. 2023), at the Appellate Division, First Department (all three cases were handled by Rosenberg & Estis, including co-author Ethan R. Cohen).

These cases suggest that the Legislature’s belated attempt to retroactively redefine “fraud” is misguided and would retroactively eliminate the repose provided to landlords under the prior law by the statute of limitations and lookback rule—exactly the result condemned by the Court of Appeals in *Regina*.

In June 2019, the New York State Legislature enacted the HSTPA, which effected a monumental change to the laws concerning rent overcharge claims, eliminating the pre-HSTPA four-year statute of limitations and “lookback rule” for rent overcharge claims.

Instead, the Court of Appeals made clear that “fraud” for purposes of establishing the “fraud exception” is no different in this context than any other context, holding: “Fraud consists of “evidence [of] a representation of material fact, falsity, scienter, reliance and injury.” In other words, the “fraud exception” requires fraud.

However, in April 2020, in *Regina*, a landmark decision, the Court of Appeals held that retroactive application of the HSTPA to a landlord’s past conduct occurring prior to the HSTPA was unconstitutional.

Instead, the court held that claims concerning a landlord’s conduct prior to the HSTPA (before June 2019) must be determined under the laws existing at the time of the conduct, as fairness would dictate.

In *Regina*, the court reviewed the pre-HSTPA law. Prior to the HSTPA, the law unequivocally provided that, if a landlord registers the legal rent with DHCR each year, then a tenant must challenge

that registered legal rent within four years, after which it is beyond legal challenge (former RSL § 26-516[a][i]).

Therefore, the pre-HSTPA statute of limitations provided that a tenant must bring a rent overcharge claim within four years of the first overcharge alleged (former CPLR 213-a; former RSL §26-516[a]).

For a timely claim, pre-HSTPA law provided a four-year lookback rule, providing that, to determine the correct legal rent, the court or DHCR must only look back at the registered or actual rent four years before the claim—known as “the base date”—and add all legal increases available after the base date to get the “legal rent.” The Court was not permitted to look beyond the base date rent (*i.e.*, the lookback rule), except to determine if the landlord committed fraud.

In *Regina*, the Court of Appeals repeatedly emphasized that “the prior statutory scheme conferred on owners clear repose” from claims regarding “conduct that occurred...many years or even decades before the HSTPA,” and condemned “upend[ing] owners’ expectations of repose relating to conduct that may have occurred many years prior to the recovery period.”

The court explained, “[b]efore the HSTPA, the combined effect of the statute of limitations and lookback rule provided owners substantial repose relating to rent increases collected more than four years prior to the filing of the complaint” and “the limitations provisions—in order to promote repose—precluded consideration of overcharges prior to the recovery period.”

The court discussed the “strong public policy favoring finality, predictability, fairness and repose served by statutes of limitations,” and stressed

that the repose embodied in the statute of limitations is no different for rent overcharge claims, explaining that: “Civil liability is always bounded by the public policy of repose embodied in statutes of limitations...Overcharge liability...is no different.”

The only exception to these principles is fraud. Namely, recognizing that a landlord who committed fraud should not be entitled to hide behind the statute of limitations and lookback rule, the Court of Appeals created a “fraud exception,” which the Legislature codified, providing that if a landlord engaged in a fraudulent scheme to destabilize an

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apartment that tainted the reliability of the rent on the four-year base date, then the court and DHCR should not rely on the actual base date rent, and instead must use DHCR’s punitive “Default Formula” to determine the legal rent. In *Conason v Megan Holding, LLC*, 25 NY3d 1 (2015), the Court of Appeals explained that the “fraud exception” also provides an exception to the four-year statute of limitations.

Thus, “fraud” is an exception to the entire statutory scheme under pre-HSTPA law. In turn, if every violation of law is deemed to be fraud, it would swallow all of the rules, and there would be no statute of limitations or lookback rule. Thus, the Court of Appeals expressly held in *Regina* that pointing to the “illegality” of past rents alone does not establish

a colorable claim of fraud, nor provides a right to relief outside of the limitations period, explaining that: “In every overcharge case, the rent charged was, by definition, illegally inflated—otherwise there would be no overcharge.”

The court further explained that just because a prior registration or conduct is revealed “to be illegal does not mean that tenants must be able to recover a certain measure of monetary damages for associated rent increases despite their failure to seek recovery within the limitations and lookback periods.”

Instead, the Court of Appeals made clear that “fraud” for purposes of establishing the “fraud exception” is no different in this context than any other context, holding: “Fraud consists of “evidence [of] a representation of material fact, falsity, scienter, reliance and injury.” In other words, *the “fraud exception” requires fraud.*

In 2023, in *Casey v Whitehouse Estates, Inc.*, 39 NY3d 1104 (2023)—the first Court of Appeals decision on these issues since *Regina*—the lower court and Appellate Division found that the owner committed fraud in the manner in which it recalculated rents following the Court of Appeals’ decision in *Roberts v Tishman Speyer Properties, L.P.*, 13 NY3d 270 (2009).

In *Casey*, the Court of Appeals reversed on appeal, found that the owner did not commit fraud, and confirmed that fraud will only allow the four-year lookback period and statute of limitations to be breached, and the punitive “Default Formula” to be used, where the alleged fraud taints the reliability of the rent on the all-important base date.

The court could have, but did not, disturb its holding in *Regina* that fraud requires “evidence [of] a representation of material fact, falsity, scienter, reliance

and injury.” In fact, two of the dissenting Judges in *Regina* joined the majority opinion in *Casey*.

After *Regina* and *Casey*, with clear guidance from the Court of Appeals, the Appellate Courts finally began to consistently apply the standard for what a tenant must prove to establish fraud as an exception to the pre-HSTPA four-year statute of limitations and lookback rule, consistently applying the common-law fraud standard in *Burrows v 75-25 153rd Street, LLC*, 215 AD3d 105 (1st Dept 2023) (“*Burrows*”), *Hess v EDR Assets LLC*, 217 AD3d 542 (1st Dept 2023), *Woodson v Convent 1 LLC*, 216 AD3d 585, 588 (1st Dept 2023), *Najera-Ordonez v 260 Partners, L.P.*, 217 AD3d 580 (1st Dept 2023), *Quinatoa v Hewlett Assoc., LP*, 205 AD3d 654, 655 (1st Dept 2022), and *Gridley v Turnbury Vil., LLC*, 196 AD3d 95 (2d Dept 2021), among other cases.

In *Burrows*, tenants at 75-25 153rd Street in Queens, NY, brought a putative class action against their landlord, asserting that the landlord’s predecessor had illegally registered their initial legal rents in 2007, by registering both legal rents and actual/preferential rents for the initial tenants, allegedly in contravention of RSC §2521.1(g), which required the initial legal rents for the “421-a building” to be the actual rents charged and paid by the initial tenants.

In 2020, more than 13 years after the initial DHCR registrations, tenants commenced a class action against the current landlord, who purchased the building in 2015, long after any challenge to the registered 2007 initial legal rents had expired under the pre-HSTPA four-year statute limitations.

The tenants sought to recover millions of dollars of damages from the current landlord, based solely on the 2007 registrations of the prior landlord, which were well beyond challenge when the current

landlord purchased the building. The tenants, however, claimed that the 2007 registrations were “illegal” and “fraudulent,” following a pattern of class actions claiming “fraud” in an attempt to avoid the pre-HSTPA statute of limitations.

The landlord (represented by the authors’ firm) moved to dismiss, arguing that the tenants’ belated claims were blatantly barred by the statute of limitations, and that tenants could never establish the “fraud exception” because fraud requires reasonable reliance, and here, the prior landlord had openly registered both legal and preferential rents with DHCR in 2007 and every year thereafter, such that any error was obvious on the face of the registrations. There was no fraud, and therefore no excuse for the tenants’ failure to bring a claim for more than 13 years.

The lower court denied the motion. On appeal, however, the Appellate Division, First Department, reversed, holding that: “As the Court of Appeals recognized in *Regina*, reasonable reliance is as much an element of fraud in this context as in others,” because “[f]raud consists of evidence of a representation of material fact, falsity, scienter, *reliance* and injury.”

Here, the alleged “inflation of the legal regulated rents set forth on the publicly filed registration statements was evident from the registration statements themselves, negating the element of reliance as a matter of law.”

Accordingly, the court held: “since plaintiffs’ claims are based upon inflated figures for legal regulated rents that were registered far more than four years before the commencement of this action in 2020, their claims are time-barred.”

The First Department continued: “Plaintiffs’ reliance on the fraud exception is unavailing because the record, and plaintiffs’ own admissions in their

complaint, establish that there was no such fraudulent scheme in this case.” “[A]s a matter of law, neither plaintiffs nor any of their predecessors could have reasonably relied on the inflated “legal regulated rent” figures that appeared on face of the registration statements.” Accordingly, the class action was dismissed.

Burrows, the first appellate decision to dismiss an untimely putative class action based on the tenants’ inability to establish fraud as a matter of law, provides an excellent example of how pre-HSTPA law balanced tenants’ rights with the repose provided by the statute of limitations to landlords who did not commit fraud, including for decade-old conduct of a landlord’s predecessor.

However, in direct response, the Legislature has now made an effort to retroactively redefine “fraud” under the pre-HSTPA law. The new bill provides that: 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...*

The problem with attempting to retroactively redefine “fraud” in 2023, for claims concerning pre-2019 conduct, is evident on its face. Just like retroactively applying the HSTPA to past claims, the bills would “upend owners’ expectations of repose relating to conduct that may have occurred...many years or even decades before the HSTPA.”

If every violation of any duty or any law is automatically deemed to be fraud, no matter how long ago, and no matter if the conduct actually constitutes fraud (*i.e.*, representation of material fact, falsity, scienter, reliance or injury), then the “fraud exception” would swallow all of the pre-HSTPA laws and rules. Moreover, if passed, the much-needed consistency that was finally emerging in cases where tenants alleged pre-HSTPA “fraud” would again fall to confusion and uncertainty, which benefits nobody.

By retroactively deeming any violation of any duty to automatically be fraud, and thereby providing an exception to the pre-HSTPA statute of limitations and lookback rule in every case, the Legislature would, in effect, be retroactively eliminating the entire pre-HSTPA scheme, which is exactly the result that the Court of Appeals held to be unconstitutional in *Regina*.

If passed, the bill will likely face the same legal challenges that parts of the HSTPA failed to overcome. However, because the Legislature is purporting only to interpret and clarify prior law concerning fraud, rather than change it, the outcome of such legal challenges is yet to be seen.