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The Four Year Rule: Where Are We Now in Light of 'Grimm'

Menachem J. Kastner and Ally Hack
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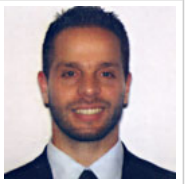

Ally Hack

Judges and legal commentators have spilled much ink trying to explain the applications and limitations of the four year rule of RSL §26-516(a) (also codified in CPLR 213-a) (the Four Year Rule). On Oct. 19, 2010, a split Court of Appeals in *Grimm v. N.Y. State Division of Housing & Community Renewal, et al.*,[1] made one more attempt.

The purpose of this article is to survey the relevant legal precedent discussing the judicial exceptions to the Four Year Rule, note the patterns, and then formulate a cogent conclusion to assist in predicting under which circumstances the Four Year Rule will apply, and under which circumstances its exceptions will apply.

The Four Year Rule placed a four year statute of limitations on claims brought by a residential tenant against his landlord based on allegations that he was overcharged in rent. See RSL 26-516 and CPLR 213-a.[2] Thus, by way of example, a tenant asserting an overcharge claim against his landlord on Jan. 1, 2011 cannot recover for any amount for which he was allegedly overcharged prior to Jan. 1, 2007—or so it seemed.

Exceptions to the Rule

The Court of Appeals and the Legislature seem to agree that a four year statute of limitations should apply to overcharge claims. After all, the Legislature passed the four year rule and the Court has not struck it down (at least not completely).

The Court of Appeals and the Legislature, however, do not agree on the scope of exceptions to the Four Year Rule and whether the four year rule is actually a four year rule. On the one hand, the words of the Four Year Rule seemed clear enough when passed by the legislature in 1983,[3] and seemed clear enough when revised and reinforced by the legislature in 1974,[4] that any claim of overcharge older than four years could not be heard. However, equally clear have been recent pronouncements by the Court carving out from the Four Year Rule an exception for a "colorable claim of fraud" (the Fraud Exception).[5]

According to the Court, fraud renders a lease "void at its inception,"[6] which effectively nullifies the four year statute of limitations. Thus, although the statutes codifying the Four Year Rule seem clear on their faces (and have remained that way), the Court has felt it necessary to exercise its inherent judicial powers to keep "unscrupulous"[7] landlords from benefitting from their own wrongdoing.

The Fraud Exception

The appearance of the Fraud Exception can best be explained by the familiar adage, "bad facts make bad law."

In *Thornton v. Baron*, the landlord and tenant attempted to contract around the Rent Stabilization laws. There, the landlord and tenant hit upon a "scheme" to remove an apartment from the protections of rent regulation whereby the tenant openly acknowledged that he was not using the unit as his primary residence, and therefore could not reap the benefits of rent stabilization. The tenant, however, benefitted from this arrangement because, with the landlord's blessing, he was able to sublet the apartment for a profit. The Court declared this agreed-to fraud to be an exception to the Four Year Rule, as it refused to allow a "landlord in collusion with a tenant [to] register a wholly fictitious, exorbitant rent and, as long as the fraud is not discovered for four years, render that rent unchallengeable."[8] As a result of the fraud, the subject lease was deemed "void at inception" and the Four Year Rule was held to be inapplicable. It is significant to emphasize that there was no "color" of fraud—it was outright fraud to avoid the rent regulations where, by agreement, the landlord obtained a deregulated apartment and the tenant obtained permission to sublet it.[9]

In *Levinson v. 390 West End Associates*,[10] a case involving the very same building as in *Thornton*, there was a similar scheme between the landlord and tenant to avoid the primary residence requirements of

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the rent stabilization law.[11] The tenant misrepresented in his lease that he was not using the apartment as his primary residence (and therefore the unit was not subject to Rent Stabilization), and the landlord charged him (and the tenant paid) an illegal rent. The First Department found that "it is clear as a matter of law that the lease, insofar as it sought to evade rent stabilization, was void."[12] In addition, the landlord and tenant in *Levinson* "conced[ed] that the rent actually charged on the base date was unlawful."[13]

Thornton and *Levinson* share a common thread—in both cases the tenants were able to circumvent the Four Year Rule by alleging that the landlord set an illegal rent in connection with a scheme to remove a regulated unit from the protections of rent regulation.[14]

Where We Are Now

In *Grimm*, upon a vacancy of the subject rent-stabilized apartment in 2000, the owner ceased registering the apartment with DHCR and unilaterally decided to charge the incoming tenants an arbitrary and illegal monthly rent of $2,000 per month. However, the owner and tenants agreed that the tenants would make certain repairs and improvements to the apartment at their own expense, and in exchange the rent would be reduced to a still-illegal monthly rate of $1,450. Sylvie Grimm, the subsequent tenant, moved into the unit in 2004 and agreed to pay the same monthly rent of $1,450. In or around 2006 (more than four years after Ms. Grimm began paying the illegal rent), after learning of the history of the apartment, Ms. Grimm commenced an overcharge case against the landlord, whereupon the landlord raised the Four Year Rule as a defense.

The Court of Appeals in *Grimm* refused to restrict *Thornton* to its facts, and refused to allow the landlord to shield itself behind the Four Year Rule for the fraud it perpetrated:

> DHCR contends that our holding in Thornton should be constrained to the narrow set of circumstances described in that case and that we should limit its application to cases involving illusory tenancies. We disagree and conclude that, where the overcharge complaint alleges fraud, as here, DHCR has an obligation to ascertain whether the rent on the base date is a lawful rent.[15] This much we saw coming.

The more burning question however, and the one that neither *Thornton* nor *Levinson* addressed, was what level of fraud and what indicia thereof a tenant would have to show in order to get around the Four Year Rule—in other words, what constitutes a "colorable" claim of fraud in the context of a rent overcharge case? This was raised and somewhat answered by the Court:

> DHCR also argues that, under the Appellate Division's holding, any 'bump' in an apartment's rent—even those authorized without prior DHCR approval, such as rent increases upon installation of improvements to an apartment—will establish a colorable claim of fraud requiring DHCR investigation. Again, we disagree. Generally, an increase in the rent alone will not be sufficient to establish a 'colorable claim of fraud,' and a mere allegation of fraud alone, without more, will not be sufficient to require DHCR to inquire further. What is required is evidence of a landlord's fraudulent deregulation scheme to remove an apartment from the protections of rent stabilization. As in *Thornton*, the rental history may be examined for the limited purpose of determining whether a fraudulent scheme to destabilize the apartment tainted the reliability of the rent on the base date.[16]

Thus, the Court finally provided at least some clear boundaries for what constitutes a "colorable" fraud claim, and in the process finally crystallized that common thread of *Thornton* and *Levinson*—to wit, in order to subvert the Four Year Rule, a tenant must allege that the landlord (i) set an illegal rent, (ii) in connection with a scheme to remove a regulated unit from the protections of rent regulation.

Notably, in *425 Third Ave. Realty Co. v. Greenfield*[17] (the first published opinion to cite to the Court of Appeals' decision in *Grimm*), the First Department did not reach the second prong where the tenant failed to demonstrate the first prong:

Nor did defendants adduce any evidence of fraud on plaintiff's part in setting the regulated rents over the years so as to render the DHCR registration records inherently unreliable.

What Litigants Can Expect

At first blush, *Grimm* may seem to be more fodder for a tenant looking to undermine the Four Year Rule, or just another chink the Four Year Rule's armor. We disagree.

Although the Court in *Grimm* sent the message that the Fraud Exception is here to stay, a close reading of *Grimm* reveals that the Court has finally put forth a framework within which the Fraud Exception must fall in order for a tenant to undercut the Four Year Rule. Now, in light of *Grimm*, not just any generalized claim of fraud will do.[18]

For instance, tenants cannot merely question an increase in rent from one year to the next, or allege that the landlord (or its agent) made a misstatement of fact with respect to an apartment's status, or raise claims that the landlord harassed him, or violated his civil rights, or any other of a host of creative arguments that tenants or their attorneys may conjure—such arguments are no longer sufficient to withstand the Four Year Rule. Rather, to make out a colorable claim of fraud, the tenant must now allege that the landlord (i) set an illegal rent, (ii) in connection with a scheme to remove a regulated unit from the protections of rent regulation.

Take the following hypothetical:

> T moves into an apartment believing it to be not regulated, when in fact the

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apartment is regulated. L does not raise T's rent for the entire 10 years that T has occupied the apartment. During that 10 year span, L fails to file yearly registrations and assures T that the apartment is not regulated and, therefore, T does not verify the apartment's status with DHCR. In year 11, L commences a non-payment proceeding against T but prior to doing so, L files 4 years of annual registrations at one time. Realizing that the apartment was subject to regulation after all, T claims overcharge from the inception of his tenancy to the present, alleging that L defrauded him by (i) telling him that the apartment was not regulated and (ii) filing four years of DHCR registrations en masse.

Under *Grimm*, T should be barred from looking back more than four years from the filing of his overcharge claim because (i) T would not be able to allege the setting of an illegal rent (T never received a rent increase), (ii) in connection with a scheme to remove a regulated unit from the protections of rent regulation (L took no action to remove the apartment from regulation, it was and remained regulated). Additionally, if T tried to argue that the initial rent was itself an illegal rent, this too would fail because "an increase in the rent alone will not be sufficient to establish a 'colorable claim of fraud.'"[19]

In light of the foregoing analysis, we cannot go along with the "gloom-and-doom" picture that legal commentators have been painting since the Court decided *Grimm*. While the Fraud Exception is not a rosy picture for landlords by any stretch of the imagination, we respectfully submit that *Grimm* is as much of a victory for landlords as they could realistically have hoped to achieve because, through *Grimm*, the lump of clay that was the Fraud Exception has at least begun to take shape.

A Practice Tip

Landlords should "smoke out" a tenant's "colorable claim of fraud" at the very inception of the case through a motion to dismiss the overcharge claim as a matter of law under the Four Year Rule. Doing so would force the tenant to lay bare the facts in support of his overcharge claim, and allow the landlord to make an informed business decision at the early stages of the litigation whether it would be more cost effective to try the case or to settle (or, reluctantly, to withdraw the proceeding). As there is generally no discovery in summary proceedings, this strategy guards against a landlord being unfairly surprised by a tenant's allegations at trial, and would avoid a *Grimm* result.

Menachem J. Kastner *heads the Real Estate Litigation division of the Commercial Litigation department of Cozen O'Connor's New York office.* **Ally Hack** *is an associate in the department.*

Endnotes:

1. 15 N.Y.3d 358 (2010).

2. "It is black letter law that in determining an overcharge complaint, the DHCR may not examine any rental history occurring more than four year prior to the filing of a complaint." See *Matter of Ogunrimde v. N.Y. State Div. of Hous. & Cmty. Renewal*, 2010 N.Y. Slip Op. 33350U, 2010 Misc. Lexis 5864 (Sup. Ct. N.Y. Co. 2010).

3. CPLR 213-a, prior to the 1997 amendment, read as follows: "[a]n action on a residential rent overcharge shall be commenced within four years of such overcharge."

4. CPLR 213-a, as a result of the 1997 amendment, was revised to be less susceptible to interpretation. It currently reads as follows: "[an] action on a residential rent overcharge shall be commenced within four years of the first overcharge alleged and no determination of an overcharge and no award or calculation of an award of the amount of any overcharge may be based upon an overcharge having occurred more than four years before the action is commenced. This section shall preclude examination of the rental history of the housing accommodation prior to the four-year period immediately preceding the commencement of the action." Notably, the statute absolutely prohibits any examination of the rental history and absolutely prohibits any award or calculation of damages based on overcharge occurring, more than four years before the tenant raises his claim.

5. Another exception carved out by the Courts, and one that seems to be less controversial, is the "apartment status exception." Under the apartment status exception, consideration "of events beyond the four-year period is permissible if done not for the purpose of calculating an overcharge but rather to determine whether an apartment is regulated." See *East West Renovating Co. v. N.Y. State Div. of Hous. & Cmty. Renewal*, 16 A.D.3d 166, 799 N.Y.S.2d 88 (1st Dep't 2005). The apartment status exception is beyond the scope of this article.

6. See *Thornton v. Baron*, 5 N.Y.3d 175, 800 N.Y.S.2d 118, 121 (2005).

7. See *Thornton* at 122.

8. Id.

9. Judge Robert S. Smith, writing the dissent in *Thornton*, advocated for a literal reading of the Four Year Rule no matter how "outrageous [the] conduct." Judge Smith went on to argue that "[s]tatutes of limitations…must by their very nature, sometimes protect outrageous conduct. Many wrongs greater than the one done in this case have gone unremedied because the victim did not seek a remedy promptly enough." See *Thornton*, at 122-23.

10. 22 A.D.3d 397, 802 N.Y.S.2d 659 (1st Dept. 2005).

11. "The arrangement in *Thornton* differed from the one here chiefly in that it involved an 'illusory tenancy,' in which the nominal tenant entering into the unlawful, purportedly nonstabilized lease never actually occupied the apartment, but immediately sublet it at a still higher rent." Id. at 662, ftnt. 3.

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12. Id. at 664-65.

13. Id. at 662-63.

14. *Sage Franklin LLC v. Cameron*, NYLJ, Dec. 21, 2005, p. 22, col. 1 (Civ. Ct. Kings Co.). There, the landlord filed registrations with DHCR that were "completely inaccurate." The court went on to hold that where "there are genuine issues of fraud" in a landlord's setting of a rent, the subject lease is "in violation of the Rent Stabilization Law [and] void[,] and [the] rents set [therein] are a nullity." The Sage Franklin fraud was the filing of false registrations with DHCR in an effort to set the rent at a higher level than the legal rent. It is not clear from the decision whether or not the landlord was attempting to take the subject unit out of rent regulation, which is an element that Court of Appeals in *Grimm* read into the Fraud Exception.

15. See *Grimm* at 366. As he did in *Thornton*, Judge Smith wrote a rather powerful dissent, which took issue with the majority's use of a "garden-variety overcharge case" to turn the Four Year Rule "into a source of endlessly complex litigation" about what constitutes a "fraudulent scheme" (at best), or (at worst) to "largely repeal the statute" altogether. Id. at 367-69.

16. Id. at 367.

17. 2010 N.Y. Slip Op. 08455 (1st Dept. 2010).

18. See *Grimm* at 367 ("a mere allegation of fraud alone, without more, will not be sufficient…").

19. Id.

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