Outside Counsel

‘Colorable Indicia of Fraud’: Not So ‘Grimm’ Anymore

Much ink has been spilled by the New York State courts, the New York State Division of Housing and Community Renewal (DHCR), and legal commentators, about the application of the “four-year rule” post- *Grimm v. DHCR* (and its progeny), and, specifically, the slow and painful erosion of the rule. The “four-year rule” is embodied in RSL 26-516(a)(2) and CPLR 213-a, and is a statute of limitations on claims brought by a residential tenant against his landlord based on allegations that he was overcharged in rent, whereby the look-back period of increases was limited to four years prior to the interposition of tenant’s overcharge claims, whether in court or before the DHCR. Prior to *Thornton v. Baron, Grimm*, and other similarly decided cases that have come down over the past decade, the four-year rule was a statute of limitations that was as much set in stone as any other statute of limitations in New York.

However, after *Thornton, Grimm*, and the other similarly decided cases, the courts began sidestepping (or trampling) the four years and examining rent increases or “bumps” well beyond four years simply based on a tenant’s mere invocation of a “colorable claim of fraud,” thereby putting the landlord to the task of refuting the tenant’s fraud allegations in order to limit the court’s or DHCR’s look-back period to the statutory four years. But, perhaps, no longer.

On June 26, 2014, the Court of Appeals revisited the issue and, by its unanimous ruling in *Boyd v. DHCR*, implicitly held that the four-year statute of limitations is still very much the rule and its “indicia of fraud” pronouncement in *Grimm* is still, as much, the exception. Merely waiving the “fraud” flag does not open the Grimm floodgates, sweeping away the four-year rule.

This article discusses *Boyd*, and other relevant case law, and addresses the main question arising therefrom: to wit, has the four-year rule been all but totally eviscerated, or is *Boyd* the beginning of the four-year rule’s revitalization?

**The Four-Year Rule**

Historically, the four-year rule, as with statutes of limitations generally, was routinely enforced.

However, courts began noticing abuse by “unscrupulous” landlords using the four-year rule as a tool to maximize their rent rolls. Growing impatient with the slow and unpredictable process of luxury deregulation, landlords allegedly began concocting (and then allegedly concealing for four years) fraudulent schemes to deregulate apartments that would otherwise allegedly be rent regulated. *Grimm* and *Thornton* are the poster children for such cases.

In *Thornton*, the landlord and tenant agreed on a mutually beneficial “scheme” to remove an apartment from rent stabilization. The court found that this agreed-to fraud created an exception to the four-year rule, and 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.” As a result of the fraud, the lease was deemed “void at inception” and the four-year rule was held to be inapplicable.

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 initially 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 Grimm began paying the illegal rent), after learning of the history of the apart-
ment, Grimm commenced an overcharge case against the landlord, whereupon the landlord raised the four-year rule as a defense. The Court of Appeals, rejecting the landlord’s attempt to hide behind the four-year rule, held:

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.

As a result of the Thornton and Grimm cases, among others, courts have trended over the past decade toward widening the scope of exceptions to the four-year rule. A reading of these cases leads to the conclusion that all a tenant need do is find some claim resembling a “fraud” and, magically, DHCR has an obligation to ascertain whether the rent on the base date is a lawful rent.

As a result of the Thornton and Grimm cases, among others, courts have trended over the past decade toward widening the scope of exceptions to the four-year rule. A reading of these cases leads to the conclusion that all a tenant need do is find some claim resembling a “fraud” and, magically, DHCR has an obligation to ascertain whether the rent on the base date is a lawful rent.

The tenant further argued that based on the condition of the apartment’s hardwood floors, bathtub, doors, fixtures, and kitchen, it was impossible for the landlord to prove $39,000 in IAIs. DHCR disagreed with the tenant and, despite the landlord submitting no evidence controverting the tenant’s claims, found that $39,000 was a reasonable amount for a landlord to have spent in IAIs in 2004—especially since the tenant was relying on nothing more than her own conclusory and self-serving opinions and observations, and especially since the 2004 vacancy was the first vacancy in that apartment in 32 years.

‘Boyd’ implicitly held that the four-year statute of limitations is still very much the rule and its “indicia of fraud” pronouncement in ‘Grimm’ is still, as much, the exception.

The Appellate Division Reverses in Favor of the Tenant. In reversing the lower court, the Appellate Division—in a split decision—found that the issues raised by the tenant rose to the level of “substantial indicia of fraud on the record,” obligating DHCR to examine the apartment history for fraud. The majority seized on the fact that the landlord never submitted any evidence attempting to rebut the tenant’s allegations that the IAIs cost far less than $39,000, and deemed irrational DHCR’s explanation that “it would not be difficult for anyone with any experience in this industry to believe that it could have taken $39,000 in IAIs to update the appearance and equipment in an apartment which had not changed hands for thirty two years.”

Shifting the burden to the landlord to explain away the tenant’s self-serving and unsupported allegations, the court concluded that “Finding that the owner ‘could have’ spent $39,000 in IAIs, where the owner never submitted any evidence controverting [tenant’s] claims is not equivalent to finding that the owner actually made improvements costing that much. Accordingly, this matter should be remanded to DHCR to give the parties the opportunity to present evidence in connection with the legality of the base rate rent.”

Writing for the dissent, Justice Judith Gishe (with Justice John Sweeney joining) set forth the standard, stating that a “colorable claim of fraud requires that the tenant present something more than a mere allegation of fraud. It requires some evidence that the owner engaged in a fraudulent act or scheme.” Gishe went on to point out that the tenant “never provided any real evidence for her conclusions on value,” failed to “account for labor costs,” and never “assert[ed] that she has any relevant experience qualifying her to opine on the value of the work done.” These facts, coupled with the fact that the landlord “complied with all registration requirements,” led Gishe to conclude that DHCR’s decision to abide by the four-year rule “had a rational basis in the record” and that there was no need for a remand to DHCR.

The Court of Appeals Sides With DHCR and the Lower Court, and Finds in Favor of the Landlord. The Court of Appeals, in a one-paragraph two-sentence unanimous decision, disagreed with the Appellate Division that DHCR acted arbitrarily and capriciously. In an anti-climactic end to a highly contentious dispute, the Court of Appeals held that the tenant failed to meet her initial burden because she failed to “set forth sufficient indicia of fraud to warrant consideration of the rental history beyond the four year statutory period.” In effect, a landlord need not refute the tenant’s “evidence” until such evidence reaches an objective demonstration of fraud to deregulate the subject.
apartment. Mere conclusory and speculative evidence is, remains to be seen, but, sure-footedly, speculative and conclusory allegations of wrongdoing), and until that is done, a landlord can sit back in silence with no burden to establish anything.

**Practical Tip:** In our opinion, overcharge cases are a two-step process. Step 1 focuses on the tenant. Has she produced enough real and objective evidence—other than improper rent increases more than four years ago, which will always be the case—to convince a court that the landlord engaged in a fraudulent scheme to deregulate the subject apartment. Inference and innuendo are no longer enough, and unless/until the tenant has met this burden, the landlord is free to sit silently at counsel’s table and observe. If the tenant altogether fails to produce sufficient evidence, her overcharge claim should be dismissed then and there in deference to the four-year rule.

Step 2 focuses on the landlord. If the tenant is successful in producing sufficient objective evidence to demonstrate the likelihood of a fraudulent scheme to deregulate the subject apartment, the four-year rule is pierced, the burden shifts to the landlord, and the landlord must justify all of the questionable rent increases, along with any other conduct proscribed by rent regulations, in which it engaged. If the landlord fails to justify the increases and conduct, the court must then engage in a fact-finding expedition (which includes the DHCR default formula) to try to set the proper rent and calculate the tenant’s damages.

**Boyd** has righted the pendulum to apply the four-year rule as it should and as it was intended to be applied. Future cases will determine what objective and “real” facts satisfy the tenant’s initial burden before the burden shifts to the landlord.

---

2. 15 N.Y.3d 358 (2010).
4. The case law generally requires the tenant to present a “colorable” or “substantial” indicia of fraud in order to have the right to look past the four-year rule to see if the landlord engaged in any fraudulent activity. In January 2014, DHCR amended the Rent Stabilization Code and reframed from using adjectives such as “colorable” and “substantial,” merely requiring a showing that the base date rent was rendered unreliable by fraud, or that the landlord engaged in a rental practice proscribed by statute. See 9 N.Y.C.R.R. 2522.6(b).
5. The question remains, how will Boyd effect future application of the revised regulations?