Rent Stabilization

Court Applies Four-Year Overcharge Rule
Warren A. Estis and Jeffrey Turkel, partners at Rosenberg Estis review the recent decision in which the Court of Appeals disagreed as to how the RSL's four year statute of limitations for overcharges should be applied where there has been a long-term illegal tenancy.

Warren A. Estis and Jeffrey Turkel

09-07-2005

In the recent case of *Thornton v. Baron*, 5 N.Y.3d 175, ___ N.Y.S.2d ____ (2005), aff'g 4 A.D.3d 258, 772 N.Y.S.2d 326 (1st Dept 2004), a divided Court of Appeals sharply disagreed as to how the RSL's four year statute of limitations for overcharges should be applied where there has been a long-term illegal tenancy. The decision revived a dispute, now in its 22nd year, as to the meaning and application of the four-year rule.

Background

Pursuant to the Omnibus Housing Act of 1983 ("OHA") (L. 1983, ch. 403), the Legislature amended RSL § 26-516(a) to impose a four-year statute of limitations on rent overcharge claims. This section provided that the base rent for purposes of calculating subsequent rent increases would no longer be the rent charged on the date the apartment first became stabilized, but would instead be "the rent indicated in the annual registration statement filed four years prior to the most recent registration statement . . . ."

Consistent with the four-year statute of limitations, the Legislature, also pursuant to the OHA, added § 26-516(g) to the RSL, which limited an owner's record keeping obligation to four years.

The courts thereafter disagreed as to how to apply the four-year rule. Some courts deemed the rent charged four years prior to the complaint to be the legal, unchallengeable base rent, and would only award the tenant a refund based on overcharges collected above the base. Other courts calculated the tenant's legal rent by going back more than four years, but limited the award to overcharges collected during the most recent four-year period.

RRRA-97

The Legislature clarified this issue in the Rent Regulation Reform Act of 1997 ("RRRA-97") (L. 1997, ch. 116). Section 33 of the RRRA-97 amended RSL § 26-516(a)(2) to provide that "no determination of an overcharge and no award or calculation of an award of the amount of an overcharge may be based upon an overcharge having occurred more than four years before the complaint is filed" (material added by RRRA-97 in italics).

Section 33 of the RRRA-97 also added the following language to RSL § 26-516(a)(2)(ii):

"This paragraph shall preclude examination of the rental history of the housing accommodation prior to the four-year period preceding the filing of a complaint pursuant to this subdivision."

Thornton

In the early 1990's, 390 West End Associates, the owner of the Apthorp, hit upon a scheme to evade the RSL. The owner would lease under-market rent stabilized apartments to tenants who would be required to admit in the lease ¿ whether it was true or not ¿ that they would not be using the apartment as their primary residence. Such admission would purportedly exempt the apartment from rent stabilization, and allow the owner to egregiously overcharge the tenant.

In December of 1992, the owner entered into such a lease with one Shlomo Baron. Although the prior stabilized rent for the apartment was $507.85 per month, Baron agreed to pay a monthly rent of $2,400 with increases beginning after three years. In July of 1993, the owner brought a declaratory judgment action against Baron in Supreme Court, seeking a declaration that the apartment was not stabilized due to Baron's alleged status as a non-primary resident. The parties immediately entered into a stipulation whereby Baron consented to the entry of a judgment declaring that the apartment was exempt from the RSL. The owner's evasive scheme was now putatively legal.

Each year thereafter, the owner registered Baron's rent with DHCR, representing that the apartment was temporarily exempt from stabilization based on non-primary residence.

Baron got in on the action as well. In January of 1993 (just one month after he executed his lease), he sublet the apartment to David Thornton and his wife, Cyndi Lauper. Baron charged an initial monthly rent of $3,250, and forced the Thorntons to represent that they would not use the apartment as their primary residence. That representation turned out to be false.

In 1996, the Thorntons commenced a rent overcharge action in Supreme Court against Baron, whom they accused of being an illusory prime tenant. That action languished for several years.

Round One: '390 West End Assocs. v. Baron'

In April of 1999, the owner moved to vacate the 1993 consent judgment against Baron, which had declared the apartment to be exempt from stabilization. The owner asserted that it wanted to rescind Baron's lease and offer a rent stabilized lease directly to the Thorntons. Although the owner's motivation for doing so is unclear, the most likely explanation is that the owner hoped to luxury deregulate the Thorntons' apartment based on high income luxury deregulation. The owner could then raise the rent to market, without having to share the profits with Baron.

In a 2000 decision, the Appellate Division vacated the 1993 consent judgment, holding that Baron's lease was void ab inito. *390 West End Assocs. v. Baron*, 274 A.D.2d 330, 711 N.Y.S.2d 176 (1st Dep't 2000). The court, concerned that "plaintiff may have benefited unjustly at the Thorntons' expense," held that its ruling was "without prejudice to the assertion of any claims among the parties and/or the Thornton tenants with respect to profits obtained in violation of the Rent Stabilization Law."

In November of 2000, the Thorntons amended their rent overcharge complaint to include the owner as a defendant.

Round Two: Thornton v. Baron

Now that the Appellate Division had voided Baron's tenancy, the issue arose as to how to calculate the Thorntons' stabilized rent. The Thorntons argued that their rent should be $507.85 per month, the 1992 regulated rent immediately preceding Baron's illusory tenancy. The owner countered that the legal regulated rent should be calculated above a base date rent of $2,496 per month, that being the rent Baron was paying four years prior to November, 2000, when the Thorntons amended their complaint to name the owner as a defendant.

Supreme Court (Diamond, J.) chose a third course, setting the rent in accordance with a default rent formula that DHCR utilizes when there is no valid rent registration statement available. The default rent formula uses the lowest rent of any similarly sized apartment in the building as of the base date, here, November, 1996. On appeal, the Appellate Division, First Department majority (Justices Rosenberger, Williams and Friedman) affirmed Supreme Court.

The dissent (Justices Tom and Buckley) argued that under the unique circumstances of the case, and notwithstanding the four year rule, the stabilized rent should be set at $507.85, the 1992 rent in effect just before the owner and Baron entered into their unlawful lease. Justice Tom wrote that the majority's methodology, using the default rent formula as of 1996

[w]ould not suffice to deter landlords from attempting to circumvent the Rent Stabilization Law, but rather, would give them a green light to deregulate a unit by use of an illusory tenancy, knowing full well that even if challenged, the stabilized rent would be based on the application of the default formula as of the date no more than four years prior to the challenge, irrespective of how many years they had reaped the benefits of their fraudulent scheme. The four-year statute of limitations under the Rent Stabilization Law was not enacted to accomplish such a result which would frustrate the purpose and spirit of the Rent Stabilization Law.[1]

The case then proceeded to the Court of Appeals as of right. The majority (Judges Kaye, G.B. Smith, Ciparick, Rosenblatt

and Graffeo), in an opinion authored by Judge Kaye, affirmed the Appellate Division. Rejecting the Thorntons' argument, the majority, citing the four year rule, held that "the apartment's rental history before November 1996 may not be examined, and the $507.85 rent in effect in 1992 is of no relevance."

The Court then rejected the owner's position, i.e., that the rent should be based on the rent that Baron was paying in November of 1996:

Reflecting an attempt to circumvent the Rent Stabilization Law in violation of the public policy of New York, the Baron lease was void at its inception. Further, because the rent it purported to establish was therefore illegal, the 1996 rent registration statement listing this illegal rent was also a nullity. Under those circumstances, we agree with Supreme Court and the Appellate Division majority that the default formula used by DHCR to set the rent where no reliable rent records are available was the appropriate vehicle for fixing the base date rent here.

The dissent (Judges R.S. Smith and Read), in an opinion authored by Judge Smith, held that owner's proposed methodology was correct:

The majority tries to reconcile its holding with the statute on the theory that the lease containing the challenged rent (entered into more than seven years before the challenge was brought) was in violation of public policy and 'void at its inception' (majority op at 181). Therefore the majority reasons, 'the rent . . . was illegal, [and] the 1996 rent registration statement listing this illegal rent was also a nullity' (majority op at 181). This approach destroys the effectiveness of the four-year time limitation, which has no point unless it protects illegal rents against challenge. If a rent is not illegal, a challenge will fail anyway and the four-year limit is unnecessary.
* * *
Here, the subtenants' remedy was to challenge the rent established by the 1992 lease within four years, and nothing prevented them from doing so.

The majority pointedly rejected the dissent's approach, ruling:

The dissent would ignore defendants' fraudulent conduct and fix the rent at an amount likely soon to result in the apartment's permanent removal from rent stabilization, thereby rewarding the owner's wrongdoing. Under the dissent's rule, a landlord whose fraud remains undetected for four years ¿ however willful or egregious the violation ¿ would, simply by virtue of having filed a registration statement, transform an illegal rent into a lawful assessment that would form the basis for all future rent increases. Indeed, an unscrupulous landlord in collusion with a tenant could register a wholly fictitious, exorbitant rent and, as long as the fraud is not discovered for four years, render that rent unchallengeable. That surely was not the intention of the Legislature when it enacted the RRRA. Its purpose was to alleviate the burden on honest landlords to retain rent records indefinitely . . . not to immunize dishonest ones from compliance with the law.

The majority and dissenting opinions reflect differing views as to the purpose of the four year rule. The majority held that the statute of limitations should not shield landlords from dishonest conduct. The dissent argued that the very purpose of a statute of limitations is repose, a goal which may well reward dishonesty. It is unclear how *Thornton* will be applied to registration statements reflecting more run-of-the-mill overcharges, intentional or otherwise.

Warren A. Estis *is a founding partner at Rosenberg Estis and* **Jeffrey Turkel** *is a partner at the firm.*

Endnote:

1. 4 A.D.3d at 330.