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RENT REGULATION

# Perhaps 'Grimm' Isn't So Grim


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New York City landlords were devastated by the Court of Appeals' 2010 ruling in *Grimm v. New York State Division of Housing and Community Renewal*, 15 N.Y.3d 358, 912 N.Y.S.2d 491 (2010), a case involving the four-year lookback period for rent overcharge claims under the Rent Stabilization Law (RSL). In *Grimm*, the subject apartment was registered as rent stabilized in 1999 at a legal rent of $587.86. In 2000, the owner increased the rent to $2,000 per month, informing the incoming tenants that if they agreed to make certain repairs and improvements, the monthly rent would be only $1,450. The incoming tenants agreed to this arrangement.

In 2004, Sylvie Grimm moved into the apartment, also paying $1,450 per month. She filed a complaint of rent overcharge with DHCR in July of 2005, based on the owner's unusual arrangement with the prior tenants. DHCR dismissed the complaint, holding that the rent four years prior to the filing of Grimm's complaint was $1,450, and had not increased thereafter. The case eventually made its way to the Court of Appeals.

In its Oct. 19, 2010 ruling, the Court of Appeals held that DHCR had erred in simply using the rent in effect four years prior to the tenant's complaint, stating 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."[1] The Court of Appeals went on to hold:

> 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, 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 established 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 (internal citations omitted).[2]

*Grimm* left many questions unanswered. Although a colorable allegation of fraud may be "sufficient to require DHCR to inquire further," how extensive will that inquiry be? Is DHCR required to subpoena witnesses or documents? Upon whom should DHCR impose the burden of proving fraud? Is the purpose of the inquiry merely to establish whether fraud has taken place, or to establish, to the penny, the lawfulness of the rent in question?

In *Friscia v. New York State Division of Housing and Community Renewal*, 2013 WL 4097901 (Sup. Ct. N.Y. Co.), DHCR and Justice Alice Schlesinger answered some of these questions. The answers may give heart to landlords who have been battered by *Grimm* and its progeny.

### 'Friscia'

*Friscia* involved an apartment at 338 E. 13th St. in Manhattan. The owner registered the apartment in 1998 as renting for $384.75 per month. The apartment thereafter became vacant and the owner performed extensive renovations. In 2000, a new tenant moved in at $2,300 per month. Later that year, the owner registered the apartment with DHCR as exempt based on luxury deregulation.

Two more deregulated tenants followed, each paying $2,000 or more per month. Danielle Friscia moved into the apartment in August of 2003 at a monthly rent of $1,900.

In 2005, Friscia commenced a rent overcharge action in Supreme Court, seeking a declaration that the apartment was in fact rent stabilized, and alleging that the owner had submitted documents to DHCR which fraudulently indicated that the apartment was no longer subject to the RSL. Supreme Court (Diamond, J.) dismissed the Supreme Court action and referred the matter to DHCR. In February of 2007, the owner filed a request with DHCR for an administrative determination as to the rent regulatory status of the apartment. The tenant, citing the Court of Appeals' ruling in *Thornton v. Barron*, 5 N.Y.3d 175, 800 N.Y.S.2d 118 (2005), argued that the jump in rent from $384.75 per month to $2,300 per month was fraudulent, and that DHCR should investigate.

In 2008, DHCR's rent administrator determined that the subject apartment was deregulated. Following various administrative and judicial appeals, the matter was sent back to DHCR for hearings as to the tenant's claims of fraud. On Aug. 6, 2012, DHCR issued a final order affirming DHCR's prior finding of deregulation. The order stated in relevant part:

> As there was no fraudulent scheme to deregulate the subject apartment and the review that the tenant is seeking is otherwise barred by the four year period

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of review with respect to overcharges, review of the rent to otherwise ascertain whether it appropriately exceeded $2,000.00 per month is time barred.

### The Article 78 Proceeding

Friscia thereafter commenced an Article 78 proceeding to challenge DHCR's order. Schlesinger addressed the tenant's various allegations in the court's Aug. 6, 2013 decision.

The tenant first alleged that the Administrative Law Judge who conducted the hearing had unlawfully placed the burden of proof on the tenant to establish that the owner had committed fraud. Pursuant to the State Administrative Procedure Act, the burden of proof is on "the party who initiated the proceeding." Here, the owner commenced the administrative proceeding in 2007, after the tenant's declaratory judgment action had been dismissed.

The court ruled for the owner in this regard. After observing that "it was the tenant who raised the issue in the first place by filing an action in Supreme Court in 2005," the court continued:

> What is more, it is wholly consistent with *Grimm*, supra, to require that the tenant go forward in the first instance with evidence of fraud so as to trigger an inquiry into the rent history preceding the four-year period for rent overcharges. After the hearing, the ALJ determined based on the "totality of credible evidence admitted and testimony adduced" that sufficient evidence of fraud did not exist that "tainted the reliability of the rent on the base date." Thus, it cannot be said that the ALJ improperly placed the burden of proof on the tenant in violation of SAPA (internal citations omitted).

The tenant also faulted DHCR's "investigation," alleging that DHCR was obligated to compel the owner to prove that the substantial rent increase between 1998 and 2000 was justified. The Supreme Court rejected this claim, stating:

> Nor has the tenant persuaded this Court that DHCR was obligated to complete an "investigation" of the fraud claims by serving subpoenas for the testimony of witnesses such as contractors who allegedly completed improvements at the premises or by demanding the production of additional documents. Petitioner has not cited any language in *Grimm* that obligated the agency to do more than it did; that is, conduct a hearing at which both sides were permitted to permit evidence in their favor and cross-examine the witnesses regarding the rental history for the subject apartment dating back to 1999, when the challenged rent increase and alleged deregulation occurred.

On this particular record, the Court finds that the agency took appropriate action to investigate the tenant's claims by conducting a hearing at which witnesses and documents were examined.

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The tenant also claimed that the owner had failed to establish through documentary evidence that the cost of renovating the apartment was sufficient to increase the legal rent beyond the $2,000 per month threshold necessary for luxury deregulation. The owner was unable to locate certain of the invoices and checks, and relied on oral testimony. The Supreme Court, affirming DHCR, held that the purpose of the hearing was to determine whether fraud had occurred, not whether the owner could justify every cent of the rent increase. The court wrote:

> Similarly unavailing is the tenant's claim that the ALJ violated…prevailing law by accepting the oral testimony of the former managing agent and copies of various documents in connection with the owner's claim that the 1999 rent increase was justified in part by individual apartment improvements. As the ALJ noted in his findings, while the documentation provided was not as detailed and comprehensive as would have been necessary to defeat a timely overcharge complaint, it was sufficient to enable the ALJ to determine whether the owner had engaged in "a fraudulent scheme to deregulate Apartment 13."

The court continued:

> Contrary to petitioner's claim, substantial documentation in the form of contracts or work orders and cancelled checks was submitted to substantiate much of what was done inside the apartment. To the extent that petitioner now objects that copies, rather than originals, of contracts and cancelled checks were considered, it is unclear whether that issue was properly preserved. In any event, it was not unreasonable for the ALJ to accept copies instead of originals in light of the fact that the work had been completed more than ten years ago. Moreover, while petitioner correctly notes that the *Grimm* court stated that DHCR was obligated to "ascertain whether the rent on the base date is a lawful rent," it did not dictate a determination of the precise legal rent using records outside the four-year period absent proof of a fraudulent scheme to increase rents (internal citations omitted).

The court concluded that there was sufficient evidence in the record to justify DHCR's determination that the cost of the renovations, in addition to other increases permitted under the RSL, were sufficient to increase the rent beyond the $2,000 per month luxury deregulation threshold.

DHCR's order, as affirmed by the Supreme Court, takes a decidedly narrow view of *Grimm*. DHCR and the Supreme Court made clear that where there is a colorable allegation of fraud, it is the tenant that must establish in further administrative proceedings that such fraud occurred. Moreover, those administrative proceedings are not akin to a rent overcharge complaint, wherein the owner must prove the legality of the rent increase; instead, the owner need only generally show that there is sufficient evidence to establish that there was no fraudulent scheme to deregulate the apartment.

It is unclear whether *Friscia* will be appealed to the Appellate Division, and it is equally unclear as to whether other Supreme Court justices will affirm DHCR's interpretation of its investigatory duties under *Grimm*. Nevertheless, for now, *Friscia* gives hope to landlords facing DHCR inquiries as to alleged fraudulent conduct.

1. 15 N.Y.3d at 366.
2. Id at 367.