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Appellate Division, First Department Case Nos. 2021-04654 and 2022-02533

# Court of Appeals
*of the*
# State of New York

BRIAN BURROWS, CRAIG CHUNG, OLECIA CHUNG, and SAM WALLER, on behalf of themselves and others similarly situated,

*Plaintiffs-Appellants,*

– against –

75-25 153RD STREET, LLC,

*Defendant-Respondent.*

**BRIEF FOR *AMICUS CURIAE* THE LEGAL AID SOCIETY IN SUPPORT OF PLAINTIFFS-APPELLANTS**

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## DISCLOSURE STATEMENT PURSUANT TO RULE 500.1(f)

Pursuant to Court of Appeals Rule 500.1(f), The Legal Aid Society states that it is a nonprofit corporation with no parent corporation or subsidiaries.

## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

### Cases

**Statutes**

**Regulations**



**Other Authorities**

## INTRODUCTION

Fraudulent schemes to circumvent rent stabilization are void. In this context, a fraudulent scheme is a deceitful practice that operates as a regulatory fraud or "fraud on the system." The illegal rents that result from a fraudulent scheme are void as a matter of public policy, meaning that the former four-year lookback period does not shield a landlord who charged and collected these rents. Therefore, when a party makes a colorable allegation that a landlord carried out a fraudulent scheme before June 2019, a court may examine more than four years of the apartment's rental history to evaluate the claim. If a court finds that a fraudulent scheme existed, there is no valid base date rent, mandating the use of the default formula to determine the legal regulated rent.

Defendant-Respondent 75-25 153rd Street, LLC and its predecessor-in-interest (the former owner) have received tens of millions of dollars in tax benefits through the program created by Real Property Tax Law § 421-a.[1] These benefits come with an important condition: units in the apartment building owned by Defendant-Respondent, where Plaintiffs-Appellants reside, are subject to rent

[1] They have also benefited from Low Income Housing Tax Credits as a "deep rent skewed" property pursuant to 26 USC §§ 42 and 142(d)(4)(b). The property's regulatory agreement requires that twenty percent of the property's units be set aside as "low income units" and established maximum rents for these units as low as $440 per month less the applicable utility allowance. (New York State Hous. Fin. Agency & 153rd St. Assoc., LLC, *Regulatory Agreement for the Kew Garden Hills Apartments* 14, 17 [May 29, 2003], available at https://a836-acris.nyc.gov/DS/DocumentSearch/DocumentImageView?doc_id=2003053000466006 [last accessed Dec. 4, 2024].)

stabilization. Because 421-a apartments are the biggest source of growth for the rent-stabilized housing stock and make up a substantial percentage of the moderately priced and affordable rent-stabilized apartments in New York City, 421-a landlords' compliance with the Rent Stabilization Law is a matter of great public concern. Chief among 421-a's requirements for rent stabilization is that the owner register the rent charged and paid by the initial tenant as the initial legal regulated rent for that apartment. This initial rent serves as the starting point for all future rent increases, meaning that rent increases are moderated over time, and rents remain affordable to a larger segment of New Yorkers than they would otherwise.

As alleged by Plaintiffs-Appellants and demonstrated by the apartments' rent histories, the former owner flouted this requirement by registering initial legal regulated rents that were thousands of dollars higher than the rents charged to the initial tenants. At the same time, it characterized the rent actually paid by the tenants—which should have been the baseline legal regulated rent—as a "preferential rent" that it could revoke. The obvious intent behind this unlawful and deceitful practice was to maintain the ability to fully or partially revoke the fictional preferential rent during a lease renewal or vacancy and to obtain inflated rent increases that would be obfuscated by the preferential rent. Defendant-Respondent has continued this practice by preserving the demarcation between the

legal regulated rent and fictional preferential rent. Thus, both Defendant-Respondent and the former owner gained millions of dollars in tax benefits while purposefully evading the most essential requirement of rent stabilization in the 421-a context. For the reasons discussed below, Plaintiffs-Appellants make out a colorable fraudulent scheme claim and are entitled to continue litigating this action.

Moreover, whether Plaintiffs-Appellants have adequately alleged a fraudulent scheme or not, or have been overcharged or not, they have adequately pleaded a declaratory judgment claim regarding the legal regulated rent for their apartments. The Rent Stabilization Code permits courts to review the pre-base date rental history when preferential rents are at issue. This ensures that both preferential rents and legal regulated rents are set accurately.

This Court should reverse the First Department's judgment and reinstate Plaintiff-Appellants' claims.

## STATEMENT OF INTEREST

The Legal Aid Society is a non-profit organization that provides free legal services to low-income New York City residents, including thousands of rent-stabilized tenants annually. Its staff members have direct experience regarding the salutary effects of rent regulation on the lives of low- and moderate-income New Yorkers and frequently provide testimony and guidance to the New York State

Legislature about policy and legislation related to affordable housing and rent regulation.

As a result, The Legal Aid Society has a unique and valuable perspective—informed by decades of assisting tens of thousands rent-burdened, low-income New Yorkers in challenging and rolling back improper rent increases—on the legislative goals underlying the rent stabilization system and courts' roles in effectuating these goals. Critically, courts must decline to lend a judicial imprimatur to schemes to evade rent stabilization's rules and regulations.

## ARGUMENT

The keystone of this Court's "fraudulent scheme to deregulate" jurisprudence is that deceitful practices intended to undermine the system of rent stabilization are void as a matter of public policy (*see Thornton v Baron*, 5 NY3d 175, 180 [2005]). The upshot is that a landlord cannot "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" (*id.*). The decision below ignores the clear import of this Court's prior decisions and the public policy that underlies them, and the Legislature swiftly repudiated it.

When a party makes a colorable allegation of a fraudulent scheme, the four-year lookback rule does not prevent courts from examining additional years of the apartment's rental history (*Matter of Grimm v State of New York Div. of Hous. &*

*Community Renewal*, 15 NY3d 358, 367 [2010]). And when a court finds that the landlord did engage in a fraudulent scheme, it must set the legal regulated rent using the prescribed default formula (*id.* at 366). In *Thornton*, *Grimm*, and *Conason v Megan Holding, LLC* (25 NY3d 1 [2015]), this Court recognized that the nullification of the results of fraudulent schemes is essential to the integrity of rent stabilization. The rule espoused in *Thornton* and its progeny is thus best viewed as a manifestation of rent stabilization's central policies, not solely as an "exception" to the four-year lookback rule. Deceitful attempts to avoid rent stabilization's basic requirements cannot stand, and courts and the Division of Housing and Community Renewal (DHCR) have the power to investigate and nullify such fraudulent schemes. It follows that rigid application of the elements of common law fraud does not comport with this Court's decisions—a conclusion that is reinforced by the 2023 Chapter Amendment that repudiated the decision of the court below and elucidated the standard for fraud in this context.

This brief begins by situating a "fraudulent scheme to deregulate" with reference to two foundational concepts: the void or illegal lease and regulatory fraud. It continues by explaining why Plaintiffs-Appellants' allegations make out a colorable claim of fraud under this Court's precedents and the 2023 Chapter Amendment that affirmed these precedents and clarified that they continue to define a fraudulent scheme. Simply put, a fraudulent scheme to deregulate is a

regulatory fraud, and Plaintiffs-Appellants have alleged one. Finally, it argues that, even if Plaintiffs-Appellants did not adequately allege a fraudulent scheme to deregulate, they may nonetheless litigate their claim seeking a declaration regarding the amount of the legal regulated rent. Defendant-Respondent's use of preferential rents means that there is no bar to examining the rental history for their apartments.

## I. **The Foundation for "Fraudulent Scheme to Deregulate"**

In *Thornton*, this Court made a clear pronouncement concerning what happens when a landlord (acting alone, or in concert with a tenant) attempts to evade the Rent Stabilization Law by means of deceit: "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" (5 NY3d at 181).

*Thornton*'s rationale directly draws on the void, or illegal, lease doctrine, which holds that leases (or terms of leases) that contravene public policy—as expressed in legislation and regulations—are void and unenforceable (*see, e.g.*, *Diamond Hous. Corp. v Robinson*, 257 A2d 492, 494-495 [DC 1969]; *Brown v*

*Southall Realty Co.*, 237 A2d 834, 836-837 [DC 1968]).[2] Indeed, the void lease doctrine is a central tenet of the rent stabilization scheme: the parties to a lease in a rent-stabilized apartment cannot subvert the protections of rent stabilization (*see, e.g.*, 9 NYCRR 2520.13, 2525.3 [b]; *Riverside Syndicate, Inc.*, 10 NY3d at 22-23; *Draper v Georgia Props., Inc.*, 94 NY2d 809, 810-811 [1999]; *Drucker v Mauro*, 30 AD3d 37, 39-40 [1st Dept 1996] ["It is well settled that the parties to a lease governing a rent-stabilized apartment cannot, by agreement, incorporate terms that compromise the integrity and enforcement of the Rent Stabilization Law."]). If courts and DHCR could not invalidate such terms, the public policy underlying rent stabilization—providing an adequate supply of affordable housing—would be seriously undermined (*Drucker*, 30 AD3d at 39-40).

An agreement that contravenes public policy is void at its inception (*Riverside Syndicate, Inc.*, 10 NY3d at 24; *Thornton*, 5 NY3d at 181). For rent stabilization, this has two main consequences. First, if a lease term is void, the passage of time does not make it valid, and a statute of limitations does not protect the lease term from challenge (*Riverside Syndicate, Inc.*, 10 NY3d at 24, citing *Pacchiana v Pacchiana,* 94 AD2d 721, 722 [2d Dept 1983]). This includes lease terms relating to rent, if the rent is connected to the void agreement (*see Thornton*,

[2] While illegal lease terms are void, the rest of the agreement (most importantly, the creation of a landlord-tenant relationship) remains intact (*Steinlauf v Delano Arms, Inc.*, 15 AD2d 964, 965 [2d Dept 1962]; *cf. Riverside Syndicate, Inc. v Munroe*, 10 NY3d 18, 24 [2008]).

5 NY3d at 181). Second, when a pre-June 2019 rent[3] is deemed illegal for this reason, courts and DHCR must use the regulatory "default formula" to calculate the legal regulated rent, as there is no valid base date rent (*id.* at 180-181; *see also Matter of Regina Metro. Co. v New York State Div. of Hous. & Community Renewal*, 35 NY3d 332, 354-355 [2020]).

This Court's later decisions expanded the concept of a fraudulent scheme to deregulate by building on *Thornton*'s connection between fraud and the void lease doctrine (*Grimm*, 15 NY3d at 365-366; *Conason*, 25 NY3d at 13-16). In those cases, this Court recognized that a landlord's actions may result in the functional equivalent of the agreement at issue in *Thornton*: in other words, a landlord may charge excessive rents while engaging in deceptive conduct calculated to prevent tenants from discovering or challenging the illegal rents (*see Conason*, 25 NY3d at 16). The "agreement" between the landlord and tenant that results from this conduct impedes the achievement of rent stabilization's policy objectives just as much as a tenant's false agreement not to use an apartment as their primary residence. As a result, it is void, and the same result follows—the base date rent is illegal, or "tainted," and the default formula must be used (*Grimm*, 15 NY3d at 362), notwithstanding the four-year lookback rule contained in former

[3] The Housing Stability and Tenant Protection Act of 2019 (HSTPA) changed the method for calculating the legal regulated rent (*see* L 2019, ch 36, § 1, part F).

Administrative Code of City of NY § 26-516 and the statute of limitations in former CPLR 213-a (*Conason*, 25 NY3d at 12-16). These laws were intended to alleviate the burden on honest landlords, "not to immunize dishonest ones from compliance with the law" (*Thornton*, 5 NY3d at 181).

II. **The Definition of "Fraudulent Scheme to Deregulate"**

This Court defined fraud in the rent-stabilized context in *Conason*: "the setting of an illegal rent in connection with a stratagem devised by [the landlord] to remove tenants' apartment from the protections of rent stabilization" (25 NY3d at 16). This definition encompasses this Court's use of the term in *Thornton* (where the landlord, tenant, and subtenants knowingly violated the Rent Stabilization Law in what they deemed a mutually beneficial arrangement),[4] *Grimm* (where the petitioner alleged that the landlord increased the prior tenants' rent substantially, informed them that the rent would be higher if they did not perform repairs and improvements themselves, and failed to provide a lease rider and file registration statements),[5] and *Matter of Partnership 92 West* (where the landlord used an illusory tenancy to seek a higher base date rent).[6]

This Court's other decisions regarding fraud define it in the negative. The mere allegation that a landlord substantially increased the rent is not sufficient

[4] 5 NY3d at 177-179.
[5] 15 NY3d at 366.
[6] *Matter of Partnership 92 West, L.P. v State of New York Div. of Hous. & Community Renewal*, 11 NY3d 859, 860 [2008].

(*Matter of Boyd v New York State Div. of Hous. & Community Renewal*, 23 NY3d 999, 1000-1001 [2014]; *see also Conason*, 25 NY3d at 16 [discussing *Boyd*]). Later, in *Regina Metro. Co.*, this Court reaffirmed the holdings of *Thornton*, *Grimm*, and *Conason* while distinguishing the facts of the cases before it (35 NY3d at 354-356). The *Regina Metro. Co.* landlords did not commit fraud because they deregulated the apartments pursuant to agency guidance. Therefore, the landlords did not intentionally and deliberately charge an illegal rent (*id.* at 356 n 7) and did not "devise a stratagem" to remove the tenants' apartments from rent stabilization.

While the *Regina Metro. Co.* decision cites the elements of common law fraud, it only does so in conjunction with a discussion of whether the landlords' conduct was willful (*id.* at 356, 356 n 7). No other decision even alludes to common law fraud. This is logical, because the tenants in those cases did not seek common law fraud remedies (*see, e.g.*, *Continental Cas. Co. v PricewaterhouseCoopers, LLP*, 15 NY3d 264, 270 [2010]; *Merry Realty Co. v Shamokin & Hollis Real Estate Co.*, 230 NY 316, 323 [1921]). Rather, they sought to nullify the illegal base date rent and, where appropriate, collect damages based on the rent they paid in excess of the legal regulated rent—which would be set by use of the default formula.

What, then, must a tenant plead and prove to establish a fraudulent scheme to deregulate? The reference to the "regulatory context" in *Regina Metro. Co.*'s

footnote 7 is appropriate, as *Conason*'s definition of fraud occurring within the highly regulated rent-stabilized housing market has much in common with the concept of "regulatory fraud" (*see 1532-1609 Ocean Ave LLC v Hertzan*, 215 NYS3d 714, 723-725 [Civ Ct, Kings County 2024]; *see also 208 Evergreen LLC v Gomez*, 216 NYS3d 871, 876 n 2 [Civ Ct, Kings County 2024]). A regulatory fraud frustrates the purpose of the regulatory scheme and renders the landlord's actions void. This section of the brief discusses rent stabilization's regulatory context before examining how regulatory fraud principles animate this Court's (and lower courts') jurisprudence and the 2023 Chapter Amendment (L 2023, ch 760, as amended by L 2024, ch 95).

A. *Rent Stabilization and Informational Regulation*

The Rent Stabilization Law creates a comprehensive framework governing rent increases and evictions. Monitoring compliance with the Rent Stabilization Law "requires a registry of rent-regulated units and an effective system for monitoring increases" (Vicki Been et al., *Laboratories of Innovation: Understanding the Diversity of Rent Regulation Laws*, 46 Fordham Urb LJ 1041, 1057 [2019]). Like many laws that are largely policed through private enforcement, rent regulation under the Rent Stabilization Law rests on a robust set of required disclosures from landlords. This "informational regulation" is integral to rent regulation, as it helps correct the informational asymmetry between

landlords and tenants regarding the rental history for a particular unit (*cf.* Margaret Kwoka, *Targeted Transparency as Regulation*, 48 Fla St U L Rev 385, 388 [2021]; Cass Sunstein, *Informational Regulation and Informational Standing*, 147 U Pa L Rev 613, 613-614 [1999]).

Landlords must disclose this information in several ways. They must annually report information such as the rent charged and tenant's name for each rent-stabilized unit to DHCR and serve a copy of the registration statement for each unit on the respective tenant (Administrative Code § 26-517 [f]). Additionally, with each vacancy or renewal lease, landlords must give tenants a DHCR-promulgated "lease rider" that explains the rights and obligations of landlords and tenants under the Rent Stabilization Law (9 NYCRR 2522.5 [c]). For a vacancy lease, the rider must also list the legal regulated rent for the prior tenant and provide the basis for any rent increase (*id.* 2522.5 [c] [1] [i]). Disclosure of this information serves a vital dual function (*see* Stephanie Bornstein, *The Enforcement Value of Disclosure*, 72 Duke LJ 1771, 1775 [2023]). Of course, the primary effect of the disclosure is to help tenants gauge the propriety of the rent charged and "nudge" them to perform further investigation and file an overcharge complaint if warranted. However, the disclosure also has a valuable secondary effect, as landlords' knowledge that they must disclose this information makes it more likely that they will adhere to the law. (*See id.* at 1775-1776.)

B. *Regulatory Fraud*

Regulatory fraud can be succinctly defined as an attempt to "hoodwink" regulators in a highly regulated industry and the public (*see Nynex Corp. v Discon, Inc.*, 525 US 128, 132, 137 [1998]). It encompasses conduct intended to escape regulatory bounds and avoid detection by regulators (*see United States v Arlen*, 947 F2d 139, 143-144 [5th Cir 1991]; *United States v Bradshaw*, 840 F2d 871, 874-875 [11th Cir 1988]; *In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 140 FRD 425, 434 [D Ariz 1991] ["The regulatory fraud they allege was designed to prevent regulators from stepping in to protect the public interest."]). This conduct, such as false or misleading statements or actions, can be directed at the public or government regulators: when someone misleads regulators and frustrates their efforts to protect the public, they indirectly mislead and defraud the public (*Bradshaw*, 840 F2d at 874-875). Moreover, because the public is entitled to rely on the integrity of the regulatory process and the truth of any representations made as part of this process, there is no need for a party injured by regulatory fraud to prove actual reliance on a false or misleading statement (*Arthur Young & Co. v United States Dist. Court*, 549 F2d 686, 695 [9th Cir 1977]).

A similarly broad conception of fraud has long been present in New York

law[7] (*see, e.g.*, *People v Lexington Sixty-First Assoc.*, 38 NY2d 588, 595 [1977]; *People v Federated Radio Corp.*, 244 NY 33, 38 [1926] ["[W]e must gather from other sources the meaning of the word 'fraud.' In a broad sense the term includes all deceitful practices contrary to the plain rules of common honesty."]). As explained on pages 21 and 22 of Plaintiffs-Appellants' reply brief, both the Martin Act (General Business Law § 352-c) and Executive Law § 63(12) use the word "fraud" to refer generally to deception or false representations. Both enable the Attorney General to combat such conduct and protect the public without needing to plead or prove the elements of fraud.

There are approximately one million rent-stabilized apartments in New York City (New York City Dep't Hous. Preservation & Dev., *2023 New York City Housing and Vacancy Survey: Selected Initial Findings* 5 [2024]).[8] Necessarily, while DHCR and the Attorney General play important enforcement functions within the rent-stabilized system, the primary "regulators" are current tenants. Pre-HSTPA, a regulatory fraud within this system had two goals:

First, to avoid rent stabilization's restrictions by treating the apartment as

[7] Additionally, this Court's other uses of the phrase "fraudulent scheme" recognize that a fraudulent scheme does not necessarily involve common law fraud and can impact people far beyond the recipient of a false or misleading statement (*see, e.g.*, *People v Roberts*, 31 NY3d 406, 417, 423 [2018]; *Byrnes v Owen*, 243 NY 211 [1926]).

[8] Available at https://www.nyc.gov/assets/hpd/downloads/pdfs/about/2023-nychvs-selected-initial-findings.pdf [last accessed Dec. 4, 2024].

deregulated and/or charging excessive rents. Landlords generally accomplished this by making false statements in leases and/or registration statements regarding the legal regulated rent and regulatory status of the apartment (*see, e.g.*, *Montera v KMR Amsterdam LLC*, 193 AD3d 102, 105-109 [1st Dept 2022]).

Second, to interfere with rent regulation's primary "nudge" function by preventing or inhibiting tenants from challenging the legal regulated rent for the apartment. While this interference took many forms, they can be classified generally as obfuscation, persuasion, and deceit. For example, a landlord may obfuscate by failing to provide lease riders or registration statements, depriving tenants of information regarding the calculation of the legal regulated rent for their apartment and their rights as rent-stabilized tenants (*see, e.g.*, *Nájera-Ordóñez v 260 Partners, L.P.*, 217 AD3d 580, 581 [1st Dept 2023]; *Butterworth v 281 St. Nicholas Partners, LLC*, 160 AD3d 434, 434 [1st Dept 2018]). A landlord may "persuade" a tenant not to file an overcharge complaint by charging them a preferential rent or otherwise giving them a "better deal" than they believe that they could otherwise obtain, removing the incentive for that particular tenant to challenge the rent's legality (*see, e.g.*, *Thornton*, 5 NY3d at 177; *560-568 Audubon Realty Inc. v Rodriguez*, 2017 NY Misc LEXIS 879, at *3 [Civ Ct, NY County, Feb. 27, 2017, 81002/2016]). A landlord may also "persuade" a tenant to move out

by revoking a fictional preferential rent,[9] triggering a vacancy increase under prior law. And finally, a landlord may practice deceit by making false statements regarding the facts or law to the tenant, such as by informing a tenant that their rent would be even higher if they did not make repairs to the apartment themselves or by making false claims regarding individual apartment improvements (*Grimm*, 15 NY3d at 366; *Nolte v Bridgestone Assoc. LLC*, 167 AD3d 498, 498 [1st Dept 2018]).

As the cases above illustrate, there is no bright-line rule to determine if a regulatory fraud occurred (or, for that matter, whether a tenant has alleged sufficient indicia of fraud to obtain license to review more than four years of the rental history) (*see, e.g.*, *Matter of Pehrson v Div. of Hous. & Community Renewal of the State of N.Y.*, 34 Misc 3d 1220(A) [Sup Ct, NY County, Nov. 15, 2011, 103323/2010]). This Court's precedents do not support the First Department's bright-line rule that there can be no justifiable reliance, and thus no fraud, when the landlord registered "inflated 'legal regulated rent' figures" (*Burrows v 75-25 153rd Street, LLC*, 215 AD3d 105, 113 [1st Dept 2023]).

Reliance cannot be an element of regulatory fraud in this context for an important reason: a landlord's stratagem to evade rent stabilization protections is

[9] Whether it was revoked or not, the future uncertainty created by a preferential rent would obviously have an effect on a tenant's long-term planning and decision whether or not to renew a lease.

usually only uncovered after the tenant on (or with) whom the landlord practiced deceit has moved on. For common law fraud, reliance must be both actual and justifiable (*Ginsburg Dev. Cos., LLC v Carbone*, 134 AD3d 890, 892 [2d Dept 2015]). In the vast majority of cases, tenants have no means to find or obtain evidence from former tenants,[10] and they will be unable to meet this pleading and evidentiary burden. Moreover, the tenants' primary "reliance" is on the integrity of the rent-stabilized system (*cf. Arthur Young & Co.*, 549 F2d at 695), and the reason why efforts to evade rent stabilization are void is because they upset the integrity of that system. Requiring a fact-intensive reliance inquiry whenever a fraudulent scheme to deregulate is alleged would reduce a central aspect of the rent-stabilized system to an infinitesimal exception.

C. *The 2023 Chapter Amendment*

The Legislature quickly repudiated the First Department's decision (*see* L 2023, ch 760, part B, as amended by L 2024, ch 95). This Chapter Amendment affirmed that the *Thornton* and *Grimm* decisions correctly articulated the public policy undergirding the Rent Stabilization Laws and explained that some courts had diverged from this authority by imposing common law fraud standards on fraudulent scheme to deregulate claims (L 2023, ch 760, part B, § 1). It announced

[10] Not to mention that the prior tenant(s) may not actually exist (*Conason*, 25 NY3d at 7) or may have been colluding with the landlord (*Thornton*, 5 NY3d at 177).

that the intent of the Legislature was to "discourage and penalize fraud against the rent regulatory system itself, as well as against individual tenants," and that it would therefore codify the "fraud exception to the pre-HSTPA four-year rule," "without expanding or reducing the liability of landlords under pre-HSTPA law" (*id.*).

This codification, then, was of the principles established by *Thornton*, *Grimm*, and *Conason*, and the cases that correctly followed them:

> When a colorable claim that an owner has engaged in a fraudulent scheme to deregulate a unit is properly raised . . . a court [or DHCR] shall issue a determination as to whether the owner knowingly engaged in such fraudulent scheme after a consideration of the totality of the circumstances.

(L 2024, ch 95, § 2-a). Specifically, "the court [or DHCR] shall consider all of the relevant facts and all applicable statutory and regulatory law and controlling authorities," and "there need not be a finding that all of the elements of common law fraud . . . were satisfied . . ." (*id.*). That is, the Legislature codified the regulatory fraud standard discussed above. The law took effect immediately (L 2023, ch 760, part B, § 3).

The Chapter Amendment's bill sponsor introduced it in direct response to the First Department's decision (Transcript, New York State Assembly at 33, Feb. 13, 2024),[11] and the legislative findings declare that the Legislature deemed that

[11] Available at https://www2.assembly.state.ny.us/write/upload/transcripts/2023/2-13-24.pdf#search=%228011%22 [last accessed Dec. 5, 2024].

certain decisions had deviated from its intent regarding pre-HSTPA overcharge claims by imposing a common law fraud standard (L 2023, ch 760, part B, § 1). Two implications follow.

First, the Chapter Amendment must apply to claims that accrued prior to its enactment, including this case. By definition, the Chapter Amendment can only apply to pre-enactment conduct, as a fraudulent scheme to deregulate claim is a creature of pre-HSTPA law (*see Casey v Whitehouse Estates, Inc.*, 39 NY3d 1104, 1106 [2023]). And the purpose of the Chapter Amendment is to clarify "what the law was always meant to say and do" (*Brothers v Florence*, 95 NY2d 290, 299 [2000]; *see also Nelson v HSBC Bank USA*, 87 AD3d 995, 998 [2d Dept 2011]). Like the City Council's 2005 Restoration Act (and its subsequent Local Law 35 of 2016), the Chapter Amendment stated that certain judicial decisions had wrongfully interpreted the Rent Stabilization Law and identified decisions that had correctly interpreted it (*see* Local Law No. 85 [2005] of City of NY § 1; Local Law No. 35 [2016] of City of NY § 2; *Nelson*, 87 AD3d at 998). It is a prototypical piece of clarifying legislation.

The inquiry before this Court is whether Plaintiffs-Appellants' complaint states a cause of action (CPLR 3211 [a] [7]). Because the Chapter Amendment clarifies what the relevant cause of action is, this Court must apply it in making this determination (*see Regina Metro. Co.*, 35 NY3d at 380 [stating that this Court

applied the lookback rule amendment to a pending case because it "merely clarified past legislative intent and reinforced existing statutory language"]; *see also Ratha v Rubicon Resources, LLC*, 111 F4th 946, 959 [9th Cir 2024] ["Because 'clarifying legislation is not subject to any presumption against retroactivity,' it 'is applied to all cases pending as of the date of its enactment" (quoting *ABKCO Music, Inc. v LaVere*, 217 F3d 684, 689 [9th Cir 2000])]).[12]

Second, the Chapter Amendment uses "fraudulent scheme to deregulate" in a broad sense. It does not only refer to a scheme that immediately and completely removes the unit from rent stabilization (usually by increasing the rent above the prior deregulation threshold). Instead, it refers to any scheme that is calculated to obtain excessive rent increases and/or increase tenant dislocation (*see, e.g.*, *435 Cent. Park W. Tenant Assn. v Park Front Apts., LLC*, 183 AD3d 509, 510-511 [1st Dept 2020]; *see also 390 W. End Assoc. v Harel*, 290 AD2d 11, 15 [1st Dept 2002] [citations omitted] [discussing purposes of rent stabilization]). In two of this Court's three seminal fraudulent scheme to deregulate cases, the tenants' rents were below the deregulation threshold (*Grimm*, 15 NY3d at 362-363; *Conason*, 25 NY3d at 6). The Chapter Amendment states that it neither expands nor reduces

[12] Defendant-Respondent's argument that subsequent legislation cannot affect a judgment (brief for defendant-respondent 52-53) is baseless. It quotes one sentence from *Hodes v Axelrod* but not the next: "*Once all avenues of appeal have been exhausted*, under this doctrine a judgment becomes an inviolable property right which thereafter may not constitutionally be abridged by subsequent legislation" (70 NY2d 364, 370 [1987] [emphasis added]).

landlords' liability under pre-HSTPA law and explicitly cites *Grimm* as an exemplar (L 2023, ch 760, part B, § 1).

Moreover, the Chapter Amendment responds to the First Department's decision in this case, which involves a 421-a building[13] with no deregulation threshold, and where the apartments have been registered as rent stabilized at all relevant times. The First Department took it as a given that a fraudulent scheme could exist under these circumstances, as has the Second Department (*see Bascom v 1875 Atl. Ave Dev., LLC*, 227 AD3d 767, 767-768 [2d Dept 2024]). Over 113,000 rent-stabilized units have been added through the 421-a program since 1994; it has been the greatest driver of additions to the rent-stabilized housing stock by a wide margin (New York City Rent Guidelines Bd., *Changes to the Rent Stabilized Housing Stock in NYC in 2023* at 11 [May 2024]).[14] It is inconceivable that the Legislature would enact legislation that responds to a case involving a 421-a building while simultaneously depriving the tenants in that very building (along with a substantial percentage of rent-stabilized tenants) of the ability to raise fraud claims.

[13] Apartments in 421-a buildings are rent stabilized so long as the tax benefit is active (Real Property Tax Law § 421-a [2] [f]). There has never been a question of whether these apartments could be deregulated during the tax exemption period, as with J-51 units (*see generally Regina Metro. Co.*, 35 NY3d at 350).

[14] Available at https://rentguidelinesboard.cityofnewyork.us/wp-content/uploads/2024/05/2024-Changes-Report.pdf [last accessed Dec. 5, 2024].

## III. **Plaintiffs-Appellants have sufficiently alleged a fraudulent scheme to deregulate.**

On a motion to dismiss pursuant to CPLR 3211(a)(7), a court "liberally construe[s] the pleading and accept[s] the facts as alleged in the complaint as true, accord[s] plaintiffs the benefit of every possible favorable inference, and determine[s] only whether the facts as alleged fit within any cognizable legal theory" (*Audthan LLC v Nick & Duke, LLC*, 42 NY3d 292, 302-303 [2024] [internal quotation marks and citations omitted]). "[W]hether a plaintiff can ultimately establish its allegations is not part of the calculus" (*id.* [internal quotation marks and citations omitted]).[15] When faced with a motion to dismiss, a court should "draw on its judicial experience and common sense" (*Ashcroft v Iqbal*, 556 US 662, 678 [2009] [citation omitted]).

In this context, courts review a complaint to determine whether it alleges a "colorable claim" of fraud (*Regina Metro. Co.*, 35 NY3d at 362)— i.e., whether the complaint contains plausible allegations regarding the setting of an illegal rent in connection with a scheme intended to evade rent stabilization's requirements (*Conason*, 25 NY3d at 16). As clarified by the Chapter Amendment, courts must consider the "totality of the circumstances," including the alleged facts and

[15] Similarly "[u]nder CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law" (*Leon v Martinez*, 84 NY2d 83, 88 [1994] [citation omitted]). Defendant-Respondent's third basis for dismissal, CPLR 3211(a)(5), is subsumed in the first two because there is no statute of limitations issue at this stage if the complaint states a cause of action.

applicable statutes and regulations (L 2024, ch 95, § 4), to gauge the sufficiency of a tenant's complaint.

Nothing in this Court's jurisprudence suggest that there is a heightened pleading standard for fraudulent scheme to deregulate claims. The imposition of a heightened pleading standard would "immunize dishonest landlords from compliance with the law" and undermine the regulatory system (*Thornton*, 5 NY3d at 181). Certainly, as with any complaint, conclusory allegations and bare legal conclusions regarding fraud are insufficient (*see Godfrey v Spano*, 13 NY3d 358, 373 [2009] [citation omitted]). Therefore, if a tenant rests a fraud allegation solely on a single rent increase, that is inadequate (*Boyd*, 23 NY3d at 1000; *Zitman v Sutton LLC*, 195 AD3d 483, 484 [1st Dept 2021]). But if a tenant alleges an illegal rent in conjunction with facts evidencing indicia of fraud—a knowing scheme to evade rent stabilization's requirements—the tenant should survive a motion to dismiss (*see, e.g.*, *Wise v 1641 Madison Partners, LLC*, 214 AD3d 550, 551 [1st Dept 2023]; *Bogatin v Windermere Owners LLC*, 98 AD3d 896, 896 [1st Dept 2012]).

Here, Plaintiffs-Appellants have sufficiently alleged a fraudulent scheme to deregulate. First, it is undisputed that the former owner registered an illegal initial legal regulated rent and a fictitious preferential rent for the first tenants of

Plaintiffs-Appellants' apartments (*Burrows*, 215 AD3d at 111).[16] Landlords of 421-a buildings are required to set the legal regulated rent as the rent paid by the first tenant (9 NYCRR 2521.1 [g]). The former owner violated this requirement by registering a substantially higher legal rent than was permissible.

Second, the First Department's rationale for dismissing the complaint should be turned on its head. The former owner's registration of inflated legal regulated rents paired with fictitious preferential rents is substantial evidence of a scheme to evade rent stabilization's limitations on rent increases because a common-sense consideration of the totality of the circumstances strongly suggests that it was intended to obfuscate, persuade, and deceive the tenants (*see* L 2024, ch 95, § 2-a; *Grimm*, 15 NY3d at 366). Registering both an initial legal regulated rent and a preferential rent obfuscated the legal requirement that the initial rent charged should have been the legal regulated rent. Similarly, the former owner committed deceit by filing false registration statements regarding the amount of the legal regulated rent. The creation of a fictional spread between the legal regulated rent and the preferential rent served to persuade tenants in two ways: it both removed an incentive for the initial tenants (who could have easily remained in place for four years) to challenge the legal regulated rent and created a lever that the former

[16] The former owner did the same thing for every apartment in the building (*e.g.*, R. at 528-577 [listing a legal regulated rent and a lower "actual rent paid"]) for each apartment. In subsequent registrations, a preferential rent is registered instead of the "actual rent paid," but the legal regulated rent was never corrected (R. at 578-687).

owner could pull (by revoking the preferential rent at lease renewal) to obtain a vacancy increase when the market conditions warranted. It is easy to imagine how a tenant living in a supposedly "affordable" unit must have felt when receiving a lease with a false legal regulated rent of $3,000 or $5,000 (R. at 753-754).

The former owner's creation of the false distinction between the legal regulated rent and the fictitious preferential rent was obviously deliberate: it did the same thing for all 388 apartments. The common-sense inference is that the former owner wished to have the ability to take the rent increases it wished, free of the limitations imposed by the Rent Stabilization Law. Giving a fake preferential rent to every tenant and maintaining this fiction over the course of a decade was a simple yet effective way to do this. There is no requirement that a landlord's fraudulent scheme be complex.

Defendant-Respondent argues that there can be no fraudulent scheme because neither Plaintiffs-Appellants nor their predecessors was overcharged (brief of defendant-respondent 55-56). But even if this is true—and Plaintiffs-Appellants provide examples of other tenants in the building whose "preferential rent" was increased by more than Rent Guidelines Board increases (R. at 753-754)—the argument misses a fundamental point grounded in the connection between a fraudulent scheme and the void lease doctrine. A fraudulent scheme to deregulate nullifies the illegal rents it engenders (*Thornton*, 5 NY3d at 181), tainting the

reliability of the entire rental history. The default formula is used because it is both impossible and impermissible to precisely "reconstruct" what the legal regulated rent would have been in the absence of the scheme (*see id.*; *see also Regina Metro. Co.*, 35 NY3d at 355-356). In the wake of a fraudulent scheme to deregulate, a landlord cannot efface the results of the scheme and somehow render the base date rent reliable. The fraudulent scheme (or the lack thereof) stands on its own and is not affected by a landlord's subsequent actions (*cf. Casey*, 39 NY3d at 1107 [stating that plaintiffs failed to show that a landlord's subsequent re-registering of apartments affected the reliability of the base date rent]).

For these reasons, this Court should reverse the court below and reinstate Plaintiffs-Appellants' overcharge claims.

## IV. **Plaintiffs-Appellants have adequately alleged their declaratory judgment claims regarding the amount of the legal regulated rent.**

The First Department dismissed Plaintiffs-Appellants' declaratory judgment claims due to the lack of a justiciable controversy (*Burrows*, 215 AD3d at 116). However, Plaintiffs-Appellants did not only seek a declaration regarding the rent-stabilized status of their apartments; they also sought a declaration regarding the amount of the legal regulated rent (R. at 45). There is a justiciable controversy regarding the latter: Defendant-Respondent has continued the practice of using the initial, unlawful legal regulated rent as the basis for calculating the legal regulated rent while maintaining the amount actually paid by the tenant as the preferential

rent (*e.g.*, R. at 162-164). Plaintiffs-Appellants challenge that practice (R. at 39-40, 45). Fixing the amount of the legal regulated rent is in keeping with the purpose of a declaratory judgment, as it would "settle controversy and discourage potential litigation" regarding future overcharges (*Krieger v Krieger*, 25 NY2d 364, 366 [1969]). To be sure, Plaintiffs-Appellants' overcharge claim is one avenue for resolving this dispute. But even if they have failed to allege a colorable claim of fraud, this declaratory judgment claim should survive dismissal, as the four-year lookback rule presents no bar to its adjudication.

Because there has been an unbroken chain of preferential rents since the apartments' rent histories' inception, a court can go beyond the base date to determine the legal regulated rent (*see* 9 NYCRR 2521.2 [c], 2526.1 [a] [2] [viii]; *Matter of West 147 & 150, LLC v New York State Div. of Hous. & Community Renewal*, 191 AD3d 419, 419 [1st Dept 2021]; *Matter of Coffina v New York State Div. of Hous. & Community Renewal*, 61 AD3d 404, 404 [1st Dept 2009]; *Matter of Pastreich v New York State Div. of Hous. & Community Renewal*, 50 AD3d 384, 386 [1st Dept 2008]).

Landlords are required to maintain the rental history "immediately preceding" each instance of a preferential rent, and courts and DHCR can review this rental history, even when it antedates the base date (9 NYCRR 2521.2 [c]). This allows courts to "establish whether the rent charged was in fact a preferential

rent . . .” (*West 147 & 150, LLC*, 191 AD3d at 419 [citing 9 NYCRR 2526.1 [a] [2] [viii]). As Defendant-Respondent and the former owner have used (and registered) preferential rents on a continuous basis since the beginning, courts can require Defendant-Respondent to produce prior leases and registration statements to determine whether the rents charged were actually preferential rents or were in fact the legal regulated rents (*see Coffina*, 61 AD3d at 404). There is no basis to dismiss this declaratory judgment claim.

## CONCLUSION

For the foregoing reasons, this Court should reverse the court below and reinstate the complaint.

January 10, 2025
New York, NY

Respectfully submitted,

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## CERTIFICATION

I hereby certify that the length of the foregoing memorandum of law, exclusive of the caption, table of contents, table of authorities, Rule 500.1(f) statement, and signature block, is 6,680 words. In making this certification, I have relied on Microsoft Word's word count function.

Evan Henley

COURT OF APPEALS
STATE OF NEW YORK

| | |
|---|---|
| BRIAN BURROWS, CRAIG CHUNG, OLECIA CHUNG, and SAM WALLER, on behalf of themselves and others similarly situated,<br><br>Plaintiffs-Appellants,<br><br>vs.<br><br>75-25 153RD STREET, LLC,<br><br>Respondent-Appellant. | APL-2024-00048<br><br>**AFFIRMATION OF SERVICE** |

I, EVAN HENLEY, an attorney duly admitted to practice before the courts of the State of New York, hereby affirm the following to be true under penalty of perjury pursuant to CPLR 2106.

1. I am not a party to this action, am over the age of 18 years, and am a resident of the City of New York.

2. On January 13, 2025, I sent three true and correct copies of amicus curiae The Legal Aid Society's Amicus Curiae Brief to each counsel of record by USPS overnight mail at the following addresses:

NEWMAN FERRARA LLP
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by enclosing three true and correct copies of the amicus brief in postpaid, addressed USPS overnight mail envelopes and causing them to be deposited in a mailbox in the exclusive control and custody of the United States Post Office within the City of New York.

I affirm this 13th day of January, 2025, under the penalties of perjury under the laws of New York, which may include a fine or imprisonment, that the foregoing is true, and I understand that this document may be filed in an action or proceeding in a court of law.

Evan Henley