

ILLEGALLY  
DEREGULATED  
RENT STABILIZED  
APARTMENTS

Identification, Risk Analysis, and Solutions

*Updated Summer 2018*

Itkowitz PLLC  
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***ILLEGALLY DEREGULATED RENT STABILIZED APARTMENTS IN NYC***

***How to identify which they are and what to do about them.***

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## CONTENTS

### **I. INTRODUCTION 4**

### **II. BACKGROUND AND BASICS – WHAT RENT STABILIZATION IS AND HOW HIGH RENT VACANCY DEREGULATION WORKS 6**

### **III. CHECK FOR A PRIOR ADJUDICATION OF THE APARTMENT’S RENT REGULATORY STATUS 8**

### **IV. J-51 AND HIGH RENT VACANCY DEREGULATION – THE LOW HANGING FRUIT OF A DEREGULATION ANALYSIS 9**

*A. J-51 and High rent Vacancy Deregulation – The Law 9*

*B. J-51 and High Rent Vacancy Deregulation – How to Figure it Out 10*

### **V. INDIVIDUAL APARTMENT IMPROVEMENT INCREASES AND HOW THEY FIT INTO A RENT REGULATORY ANALYSIS 11**

*A. A court or the DHCR can look back as far as they want to determine whether an apartment is subject to Rent Stabilization. 11*

*B. The somewhat erratic and evolving jurisprudence involving rent overcharges and the four-year statute of limitations. 12*

*1. The Four-Year Look Back Period on an Overcharge Claim 13*

*2. The Colorable Claim of Fraud Exception to the Four-Year Look Back Period on an Overcharge Claim 14*

*3. In order for there to be a finding of fraud, there has to be a game of some kind, often building-wide, being perpetrated by the landlord. 14*

*4. In most cases, the court does not find a colorable claim of fraud exception to the four-year look back period on an overcharge claim. 16*

*5. Whether there is a colorable claim of fraud is, inherently, a fact issue, not an issue of law. Therefore, the fraud exception to the four-year look back period on an overcharge claim is not an issue that is susceptible to summary judgment. 17*

*C. The heightened scrutiny that IAI’s are receiving. 18*

*D. List of factors for a tenant to consider when deciding whether or not to challenge an apartment’s deregulated status based upon an allegation of insufficient IAI’s. 20*

### **VI. THE ALTMAN CASE WAS OVERRULED! 21**

### **VII. ANALYSIS AND RISK MITIGATION 21**

*A. A rent regulatory analysis needs to be expressed in terms of numerical percentages in order to be useful as a risk analysis and mitigation tool. 21*

*B. A CHART!!! AND A CONCLUSION 21*

## I. INTRODUCTION

Whether it's the *Roberts* case and J-51, the High Rent Vacancy Deregulation threshold, or DHCR Operational Bulletin 2016-1 and the heightened scrutiny on Individual Apartment Improvement Increases – these days it's tough to know whether an apartment was properly taken out of Rent Stabilization.

Whether or not an apartment is subject to Rent Stabilization is often of existential importance to that unit's landlord and its tenant.

To the landlord, it could mean the difference between success or failure of the building. Most multifamily buildings in NYC are owned by small businesses. Many of the landlords that I work for are new businesses run by millennials, New York City's next generation of landlords, hungry for information and learning as they go along. Many of my clients are multi-generational family businesses, run by people who have known every tenant's first name for the last thirty years. New to the game or in it for decades – my overwhelming experience with landlords in over twenty years in this industry is that most want to do the right thing. Yet they are often making decisions with the bad or partial information that is all they can get their hands on. On top of which, many of these owners are barely making it these days under the burden of taxes, bank fees, and expenses. If an apartment that an owner reasonably thought was free market manifests as Rent Stabilized and comes along with a bunch of litigation and an overcharge, it can be devastating.

To a tenant, whether her apartment is Rent Stabilized or not could be the difference between being able to remain in New York City and having to leave a job, family, and all that is familiar and well-loved behind. I had three friends, women my age and their families, simply priced out of NYC in the last two years. They earned too much money to qualify for subsidized housing, yet they did not make enough to pay free market rents, and they never found themselves Rent Stabilized apartments. It was the price of housing that drove them to Virginia, Connecticut, and back to Ireland. New York City is a lesser place for their absence. In a very real sense, every apartment that gets deregulated illegally is a mortal blow to New York City's middle class.

And how is anyone, landlord or tenant, supposed to know if a particular apartment is subject to Rent Stabilization? Rent Stabilization is a complicated area, and those of us who practice in it every day cannot agree. The Courts are doing their best to sort this all out, but our system of jurisprudence takes time. Finally, the New York State Division of Housing and Community

Renewal is heavily burdened with an immense caseload, and unable to provide the higher-level guidance to the people and businesses who desperately need it.

**This article’s aim is to explain in very clear language, and with reference to the relevant statutes, regulations, and case law, to *both* landlords and tenants, how to tell (as of this writing) if a free-market apartment is actually subject to the Rent Stabilization Law.** I hate articles by lawyers that conclude only by telling you the problem, and leaving you with a “call to action” to “*call an experienced attorney (this is legal advertising)*”. Yeah, this may be legal advertising, but I always try to leave you with something that is, in and of itself, *valuable* – that sheds some light in the darkness. What I believe is of intrinsic value here is that the article is structured to take you through the methodical analysis I have developed for determining an apartment’s rent regulatory status. I start where it makes the most sense and build from there. I cover both the law and its practical applications.

No section of this article will be an exhaustive treatment of the particular section’s topic. I have a 30-page article, for example, elsewhere on my website, on J-51 and Rent Stabilization, and that piece is not nearly everything one could say on the topic. Obviously, I am not copying that herein. Here, I am giving you an overview of J-51 and showing you how I do a rent regulatory analysis with respect to J-51.

Whether you ever call or email me, whether you take this article to your own lawyer for their reference or whether it merely opens your eyes, whether you are landlord or tenant, whether you are a young legal aid lawyer reading this because you wish you had more training or my staunchest competitor in private practice who reads my stuff and rolls your eyes (*you know who you are*) – please accept that if I fail to make this occluded topic perfectly clear, at least I am out here trying. *Vox clamantis in deserto*<sup>1</sup>. But, hey, you can’t blame a girl for trying.

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<sup>1</sup> [http://www.latin-dictionary.org/Vox\\_clamantis\\_in\\_deserto](http://www.latin-dictionary.org/Vox_clamantis_in_deserto).

## **II. BACKGROUND AND BASICS – WHAT RENT STABILIZATION IS AND HOW HIGH RENT VACANCY DEREGULATION WORKS**

If you already understand Rent Stabilization and High Rent Vacancy Deregulation, you can skip this section and go to the juicier stuff below.

Rent Stabilization applies to many residential tenancies in New York City. Rent Stabilization limits the rent an owner may charge for an apartment, restricts the right of an owner to evict tenants, and imposes other requirements on landlords and tenants – such as a great deal of paperwork. Rent Stabilization is overseen by the New York State Division of Housing and Community Renewal (“DHCR”). Omnibus Housing Act § 3 (L. 1983, c. 403).

Rent Stabilized tenants are entitled to leases and automatic one- or two-year lease renewals, at the tenant's choice. 9 NYCRR § 2523.5(a). There is also a required 11-page Rent Stabilized lease rider.

Family members residing a Rent Stabilization apartment often have succession rights to the leases. 9 NYCRR § 2523.5 (b)(1); 9 NYCRR § 2520.6 (o). Thus, you often get multigenerational Rent Stabilized tenancy that last for decades.

Rent increases for Rent Stabilized tenants are controlled by the New York City Rent Guidelines Boards, which sets maximum rates for rent increases once a year that are effective for leases beginning on or after October 1st of each year. Landlords usually feel that these rates are too low. Tenants usually feel the increases are too high.

Owners are required to register all Rent Stabilized apartments initially and then annually with the DHCR and to provide tenants with a copy of the annual registration.

In New York City, the New York City Rent Stabilization Law governs Rent Stabilized tenancies, and is codified in the New York City Administrative Code (“NYC Admin. Code”) § 26-501 *et seq.* The DHCR has promulgated a set of regulations that also govern Rent Stabilized tenants in New York City known as the Rent Stabilization Code (“RSC”), codified at 9 NYCRR §§ 2520.1 *et seq.* These statutes appear in the Unconsolidated Laws of the State of New York.

**There is no official list somewhere that definitively tells the world, which apartments are subject to Rent Stabilization and which are not.** But the records the DHCR

maintains contain information that is largely self-reported by landlords and that is not controlling with regard to an apartment's Rent Stabilization status. Therefore, year after year a landlord can report to the DHCR that an apartment is “permanently exempt”, but that does not make it so.

Moreover, a current or former tenant may have signed a document acknowledging that an apartment is not subject to Rent Stabilization. But this, also, does not make it so. Parties may not contract in or out of Rent Stabilization coverage. *Thornton v. Baron*, 5 N.Y.3d 175 (2005).

How do you ever get a definitive answer on an apartment's Rent Stabilization status? With some exceptions, the last word on whether or not an apartment is Rent Stabilized is in the hands of the courts (or the DHCR). Until a judge is satisfied that an apartment is not Rent Stabilized, the matter is always, in some measure, unsettled.

Why is this so complicated? Because it is. There are many statutes and mountains of case law that, stretching back to the 1970's, that, when woven together, make up the rent regulatory scheme in New York City. There are rules, and exceptions to the rules, and exceptions to the exceptions to the rules.

In general, if a Building was built before 1974 and contains six or more units, then the apartments therein are Rent Stabilized (NYC Admin. Code 26-505(b)) unless certain exceptions apply. One of the few exceptions that would take an apartment in a building, which is built before 1974 and has more than six units, out of Rent Stabilization is **High Rent Vacancy Deregulation**.

High Rent Vacancy Deregulation means that, in conjunction with a vacancy, an apartment achieved a **legal regulated rent** of a certain threshold. New York City Administrative Code § 26-504.2(a). In general, the High Rent Vacancy Deregulation threshold from 1993 forward was \$2,000.00, then after January 23, 2011 the threshold was \$2,500.00, then after July 1, 2015 the threshold became \$2,700.00 and it rises each January 1 by the same percentage as the most recent one year renewal adjustment adopted by the relevant rent guidelines board.

One way to hasten getting to the deregulation threshold is to do Individual Apartment Improvements (“IAIs”). A landlord may secure a rent increase based on a substantial modification or enlargement of dwelling space and/or upon provision of additional services, improvements, equipment, furniture, or furnishings to a Rent Stabilized unit. NYC Admin. Code § 26-511(c)(13); 9 NYCRR § 2522.4(a)(1). No tenant consent is required when the IAI is made during

a vacancy. 9 NYCRR § 2522.4(a)(1). DHCR distinguishes between “improvements” and “repairs” or “maintenance” in determining whether the work qualifies for the increase. *Rockaway One Co., LLC v. Wiggins*, 9 Misc. 3d 12 (App. Term 2004), *order rev’d on other grounds*, 35 A.D.3d 36 (2d Dep’t 2006). In a building with 35 or fewer apartments, a landlord may add to a Rent Stabilized tenant’s rent the equivalent of one–fortieth (1/40) of the cost of the new service or equipment, including installation costs, but not finance charges. NYC Admin. Code § 26–511(c)(13); 9 NYCRR § 2522.4(a)(4). For example, if a new refrigerator is installed in an apartment and the landlord’s expense is \$400.00, then the tenant’s monthly rent may be increased by \$10.00 (1/40 x \$400). This kind of IAI often juices the rent to the High Rent Vacancy Deregulation threshold. DHCR recently issued Operational Bulletin 2016–1 “Individual Apartment Improvements”, and it contains a great deal of guidance on this topic (we will examine it in detail below).

### **III. CHECK FOR A PRIOR ADJUDICATION OF THE APARTMENT’S RENT REGULATORY STATUS**

The first step in an apartment’s rent regulatory analysis is to check for a prior adjudication of the apartment’s rent regulatory status.

I am only as good as my information. The less source materials I have and the more guessing I have to do, the less reliable the analysis will be. As an initial matter, I always ask a landlord–client for the DHCR “Cases By Building” report or for a tenant–client to do a DHCR requisition for everything regarding the apartment.

TIP: Never do a Freedom of Information Law Request (FOIL) request at DHCR on a building that landlord has just purchased or that tenant lives in. If you have an existing association with a building as either landlord or tenant, the quickest way to get information from DHCR is a “Requisition” (different from a FOIL).

I then run my own “litigation search” on E–Courts, the New York State Court System’s free online database. But this typically only shows recent, active cases.

I also run the address and the previous owners and current owner of the building back to 1984 using standard research databases typically only available to lawyers.



**What you are looking for is any evidence that the question you are attempting to answer was already answered by a court of by DHCR and that you are, therefore, collaterally estopped from re-litigating such.** See *Gersten v. 56 7<sup>th</sup> Avenue LLC*, 88 AD3d 189 (1<sup>st</sup> Dept. 2013) (Preclusive effect must be given to earlier DHCR deregulation orders under administrative finality principles. If the issue of Luxury Deregulation during J-51 came up in front of DHCR or a court, and the DHCR or the court ruled that the deregulation was lawful, then such decision could never be challenged if the applicable appeals period had run.)

It should not surprise you that your question about an apartment's status has been raised by others before and has even been settled, for better or worse.

#### **IV. J-51 AND HIGH RENT VACANCY DEREGULATION – THE LOW HANGING FRUIT OF A DEREGULATION ANALYSIS**

Next, I check to see if High Rent Vacancy Deregulation happened during J-51. The low-hanging-fruit of improperly deregulated apartment detection is brought to us by the J-51 cases. If an apartment was High Rent Vacancy Deregulated during J-51, even if that happened many years ago, the unit is still Rent Stabilized. The implications of re-registration, what the rent should be, and overcharges may still be unsettled, but the issue of regulatory status is actually quite clear.

##### **A. J-51 and High rent Vacancy Deregulation – The Law**

New York City's J-51 program was a tax exemption and/or abatement program for multi-family property owners. Real Property Tax Law § 489. Rental units in buildings receiving J-51 must be registered with the DHCR and are generally subject to Rent Stabilization for at least as long as the J-51 benefits are in force. 28 RCNY 5-03 [f].

In 2009, in *Roberts v. Tishman Speyer*, 13 NY3d 270 (2009), New York State's highest court (the Court of Appeals), held that a Rent Stabilized apartment in a building for which the owner receives J-51 tax benefits is NOT subject to the Luxury Deregulation provisions of the Rent Stabilization Law until the tax benefit expires or, if the lease contained a notice that the unit would be deregulated upon expiration of the tax benefit, until the apartment becomes vacant after expiration of the tax benefit. This was a huge deal because landlords had spent years deregulating thousands of Rent Stabilized apartments in buildings receiving J-51 benefits.

In 2011, the Supreme Court, Appellate Division First Department, held (in another case with the same name as the first *Roberts* case; so we will call this case “*Roberts 2*”) that the Court of Appeals decision in *Roberts* could have retrospective effect. *Roberts v. Tishman Speyer Properties*, 89 A.D.3d 444 (1<sup>st</sup> Dept. 2011). *Roberts 2* was actually more devastating than the first *Roberts* case, because it made every apartment ever wrongly deregulated under J-51 a potential litigation.

Then *Gersten v. 56 7<sup>th</sup> Avenue LLC*, 88AD3d 189 (1<sup>st</sup> Dept. 2013), was a dispute between tenants and a new building owner. The owner took over the subject property in 2009, **a decade** after the former owner had deregulated the apartment pursuant to a 1999 DHCR High Rent Vacancy Deregulation order. Tenants commenced the action seeking a declaration that the 1999 High Rent Vacancy Deregulation order was void *ab initio* (from the beginning) pursuant to *Roberts*. Among other things, the *Gersten* Court totally rejected the statute of limitations defense for landlords where an apartment was improperly deregulated during J-51, even if it happened many years ago. Courts have uniformly held that landlords must prove the change in an apartment’s status from Rent Stabilized to unregulated even beyond the four-year statute of limitations for rent overcharge claims. *Gersten v. 56 7<sup>th</sup> Avenue LLC*, 88AD3d 189 (1<sup>st</sup> Dept. 2013).

In *72A Realty Assoc. v. Lucas*, 101 AD3d 401 (1<sup>st</sup> Dept. 2012) the landlord raised the issue – What happens when an apartment was improperly deregulated under J-51, but now J-51 has expired? Is a landlord expected to re-register such units as Rent Stabilized? Even though J-51 is long-gone now? The Court answered the question in the affirmative -- that the J-51 benefits subsequently expired does not support a landlord’s claim that the apartment must be denied ongoing regulated status. Therefore, if a Rent Stabilized apartment was improperly deregulated under J-51, and J-51 has since expired, landlord needs to give the occupant of the apartment a Rent Stabilized lease and re-register the apartment.

## **B. J-51 and High Rent Vacancy Deregulation – How to Figure it Out**

To check if a building was receiving J-51 tax benefits during a High Rent Vacancy deregulation you must first isolate the time of the deregulation using the DHCR Registration Rent Roll for the apartment. Then you have to go online and fumble with these NYC

Department of Finance websites and charts<sup>2</sup> and get an idea of whether or not J-51 was in the Building at that time.

If it seems like J-51 was burning off just as the new tenancy was beginning, you need to drill down the actual tax bills for the fiscal quarter encompassing the deregulation. J-51 does not stop suddenly, it winds down, becoming a smaller and smaller benefit as time goes on. I have seen landlords assume that J-51 was over before it actually was, and thus, prematurely deregulate.

## V. INDIVIDUAL APARTMENT IMPROVEMENT INCREASES AND HOW THEY FIT INTO A RENT REGULATORY ANALYSIS

Analyzing an apartment's rent regulatory status vis-à-vis its Individual Apartment Improvement history is the meatiest part of this article. Unlike the J-51 piece, it isn't so simple. There is a lot of law surrounding the IAI piece and as many practical considerations. So let's get down to business.

### A. A court or the DHCR can look back as far as they want to determine whether an apartment is subject to Rent Stabilization.

We first need to note that a court or the DHCR can look back as far as they want to determine whether an apartment is subject to Rent Stabilization. **While a rent overcharge claim is subject to a four-year look back period, a claim for improper destabilization is not.**

*72A Realty Associates v. Lucas*, 28 Misc.3d 585 (N.Y. City Civ. Ct., 2010), *Affirmed as Modified by 72A Realty Associates v. Lucas* 32 Misc.3d 47, (AT1st 2011), *Affirmed as Modified by 72A Realty Associates v. Lucas*, 101 A.D.3d 401, (1<sup>st</sup> Dept. 2012); *Gersten v. 56 7<sup>th</sup> Avenue LLC*, 88 AD3d 189 (1<sup>st</sup> Dept. 2013).

**As a practical matter, however, when divorced from the possibility of an overcharge award, many tenants lack the resources or the desire to litigate with their landlords over an apartment's rent regulatory status.** I include an example below, modified from a recent inquiry I actually received.

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<sup>2</sup> <http://webapps.nyc.gov:8084/cics/cwba/dfhwbtt/abhq>; <http://www1.nyc.gov/site/finance/benefits/benefits-j51.page>.

### Example

Tenant thinks he has a possible rent overcharge case. The dates and the math come down to this – the rent jumped in 2006 in such a way that the landlord would have had to have spent \$6k in IAI’s on the apartment. The present owner owned the building in 2006 and has receipts and cancelled checks for the \$6k. The documentation is not perfect, but it exists. Tenant moved in five years ago, in 2011. Tenant reports that, when he moved in, the apartment was obviously not newly renovated, but neither was it dilapidated. The tenant does not have any pictures from 2011 nor any record of complaints until the present day when the overcharge idea popped into his head. The tenant doesn’t have much, if anything, to say to counter the allegations that the work was done. The rent is now \$2,900.00 per month. Four years ago, it was only \$2,800.00 per month. In fact, with the soft rental market, it is unlikely that landlord would raise the rent much next year anyway.

Even if tenant could somehow prove that the \$6k in IAI’s did not happen 10 years ago and that, therefore, tenant is entitled to a Rent Stabilized lease, what is the real upside of all that litigation for the tenant? The four-year statute of limitations (as we will see below) likely insulates the landlord from any overcharge. All tenant would be litigating for is the right to stay, at the current rent (which is already market for the unit), which would then be limited by Rent Guidelines Board increases. There is some upside for tenant and some downside for landlord, but not a lot, and that only comes after a protracted fight without a high likelihood of tenant prevailing, as per the fact pattern I laid out here.

In light of the foregoing, we must next consider the somewhat erratic and evolving jurisprudence involving rent overcharges and the four-year statute of limitations.

### **B. The somewhat erratic and evolving jurisprudence involving rent overcharges and the four-year statute of limitations.**

My supposition being that overcharges describe IAI’s disputes, we must consider the somewhat erratic and evolving jurisprudence involving rent overcharges and the four–year statute of limitations.

1. **The Four–Year Look Back Period on an Overcharge Claim**

CPLR § 213–a provides a four–year look–back period for rent overcharge claims and states in pertinent part that:

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.

Furthermore, the Rent Stabilization Law at § 26–516, as amended by the Rent Regulation Reform Act of 1997 (RRRA) states:

[A] complaint under this subdivision shall be filed with [DHCR] 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 an overcharge may be based upon an overcharge having occurred more than four years before the complaint is filed ... 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”.

The RRRA “clarified and reinforced the four–year statute of limitations applicable to rent overcharge claims ... by limiting examination of the rental history of housing accommodations prior to the four–year period preceding the filing of an overcharge complaint” *Thornton v. Baron*, 5 N.Y.3d at 175 (2005); *Matter of Cintron v. Calogero*, 15 N.Y.3d 347, (2010).

To effectuate the purpose of the four-year limitations period in rent overcharge cases, DHCR regulations set the “legal regulated rent” as the rent charged on the “base date,” which is the “date four years prior to the date of the filing of [the overcharge] complaint” plus any subsequent lawful increases. 9 NYCRR 2520.6[e], [f][1]; 2526.1[a][3][i].

2. **The Colorable Claim of Fraud Exception to the Four-Year Look Back Period on an Overcharge Claim**

There is, however, an exception to the four-year look-back period when there is “colorable claim of fraud.” The leading case regarding the exception to the four year statute of limitations is *Matter of Grimm v DHCR*, 15 N.Y.3d 358 (2010). In *Grimm*, the DHCR expressed a fear that “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 [would] establish a colorable claim of fraud requiring DHCR investigation.” From *Grimm* we learn that:

[g]enerally, 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.

*Grimm* has numerous progeny, each contributing to and shaping the evolving requirement for what a tenant needs to do to demonstrate a “colorable claim of fraud.” As of this (2016) writing, on Westlaw there are 29 citing references to *Grimm* in case law and 34 citing references to *Grimm* in trial court orders. Some of those cases and trial court orders are devoid of fact patterns and only contain holdings. If one reads all 63 cases, guidance emerges about when there is a colorable claim of fraud and when there is not.

3. **In order for there to be a finding of fraud, there has to be a game of some kind, often building-wide, being perpetrated by the landlord.**

First, let us consider the cases where the courts did find fraud. The court will find fraud where the Landlord is engaged in a “stratagem devised ... to remove tenants’ apartment from the protections of rent stabilization...”, such as the complex illusory tenancy scheme in *Conason v. Megan Holding, LLC*, 25 N.Y.3d 1 (2015), or where landlord forced tenants into agreeing not to

use their apartments as their primary residences, in contravention of public policy, as in *Pehrson v. DHCR*, 34 Misc.3d 1220(A) (Sup. Ct. NY Cty. 2011).

The court will also find fraud where a bogus preferential rent was offered and then suddenly revoked, as in *1290 Ocean Realty LLC v. Massena*, 46 Misc.3d 1223(A) (NYC Civ. Ct. NY Cty. 2015), where the IAI's would have needed to be \$18,000, DHCR's rent registration history made no mention of the increase; landlord's own spreadsheet of expenditures for the apartment did not justify the \$18k increase; landlord failed to give tenant a Rent Stabilization rider for his vacancy lease; landlord charged tenant a "preferential rent" until it thought the four-year statute of limitations had run. In *DL Major Const. Co. Group LLC v. Carchi*, 43 Misc.3d 1219(A) (Civ. Ct. Kings 2014), the court found a colorable enough claim of fraud had been raised where there was a suspicious preferential rent agreement, bad conditions existed in the apartment, and there were many building-wide HPD violations, and 13 HPD violations for the subject premises.

In *Bogatin v. Windermere*, 98 AD3d 869 (1st Dept. 2012), tenant raised a colorable issue of fraud when he included a contractor's estimate as part of his extensive proof that IAI's had not taken place.

In other words, in order for there to be a finding of fraud, there has to be a game of some kind, often building-wide, being perpetrated by the landlord.

Moreover, the elements of fraud need to be found. In general, the essential elements required to sustain a cause of action for fraud and deceit based on misrepresentation are that a representation was made as a statement of a material, existing or preexisting fact, which was untrue' and known to be untrue by the party making it; that it was made with the intent to deceive and for the purpose of inducing the other party to act upon it; and that the other party did in fact justifiably rely on it and was thereby induced to act or refrain from acting, to his or her injury or damage. *Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173 (2011); *Ross v. Louise Wise Services, Inc.*, 8 N.Y.3d 478 (2007); Thus the court held in *Antollino v. Wright*, 2015 WL 5096025 (NY Cty. Sup. Ct. 2015) that:

To establish fraud on the part of defendants, so as to enable Wright to search the rental history beyond the four-year period, there must be evidence of a misrepresentation or an omission of a material fact made by 620 LLC, knowing it to be false, that was relied upon by Wright to her detriment (*Mandarin Trading Ltd. v Wildenstein*, 16

NY3d 173, 178 [2013]; *Grimm*, 15 NY3d at 367 [“What is required is evidence of a landlord’s fraudulent deregulation scheme to remove an apartment from the protections of rent stabilization”] ).

Consequently, in order to establish fraud on the part of 620 LLC, there must be sufficient proof that they either knew that Apartment 31 was not subject to rent deregulation ...

But see *557–559 Wilson Avenue Realty v. Murdough*, 66636/2014, NYLJ 1202720127221 (Civ. Ct. L&T Kings Cty. 2016). Tenant moved into the subject premises in April 2010 with a monthly rent of \$1,200.00. Tenant alleged that the apartment “looked nice” when she moved it, but that the bathroom fixtures and files had not been replaced in years, the kitchen cabinets, counter tops, and appliances also looked more than five years old, and the windows were “old timey”. Tenant disputed landlord’s claim that the apartment was exempt from Rent Stabilization, and argued that in order for the landlord to have deregulated the subject premises, he would have had to have spent \$47,070.00 in IAIs. Tenant annexed the DHCR apartment registration history, indicating a rent of \$450.00 per month in 2003, and an increase to \$1,724.85 one year later. The 2004 registration indicated “pref rent vac/leas imprvmt”, and the registration in 2005 indicated “high rent vacancy exempt”. Tenant argued that landlord improperly increased the rent and deregulated the apartment.

4. ***In most cases, the court does not find a colorable claim of fraud exception to the four–year look back period on an overcharge claim.***

In most cases I surveyed, the court did not find a colorable claim of fraud that justified looking back beyond four years. In *Boyd v. DHCR*, 110 AD3d 594 (1st Dept. 2013) *revsd.* 23 NY3d 999 (2014), a case where the tenant did not raise a colorable claim of fraud, the tenant had only one bit of evidence of the alleged fraud, and that was her own opinion after looking around her apartment and then going to Home Depot. Yet in *Boyd* the rent increased from \$572 to \$1,750 in three months and the owner never submitted any evidence showing it actually made \$39,000 in alleged improvement. Still the court in *Boyd* did not find a colorable claim of fraud and the statute of limitations was not overcome.

Most of the Illegal–High–Rent–Vacancy–J–51 cases find no colorable claim of fraud to justify overcoming the four–year look back period. *72A Realty Associates v. Lucas*, 32 Misc.3d 47 (AT 1<sup>st</sup> 2011). In these cases the court is saying that just because the landlords were totally wrong



about the deregulations, does not mean that the deregulations were part of a fraudulent scheme. These deregulations were just mistakes. See also *Fox v. 12 East 88th LLC*, 2016 WL 6070824 (Sup. Ct. NY Cty. 2016) and *Gomez v. Rossrock LLC*, 2016 WL 3256977 (Sup. Ct. NY Cty. 2016).

Irregularities in the rent roll do not necessarily mean fraud. *White v. DHCR*, 2013 WL 753516 (Sup. Ct. NY Cty. 2013). Neither does improperly calculated rent. *Lexington House LLC v. DHCR*, 31 Misc.3d 1215(A) (Sup. Ct. NY Cty 2011). Nor is there fraud when the discrepancy between the rent charged and the legal rent is minor and there is no attempt to remove the apartment from rent regulation. *B-U Realty Corp. v. Kiebert-Boss*, 50 Misc.3d 1220(A) (NYC Civ. Ct. NY Cty, 2016).

Generally, an increase in the rent alone will not be sufficient to establish a colorable claim of fraud. *IWC 879 Dekalb, LLC v. Walsh*, 46 Misc.3d 1227(A) (NYC Civil Ct. Kings Cty. 2015).

5. **Whether there is a colorable claim of fraud is, inherently, a fact issue, not an issue of law. Therefore, the fraud exception to the four-year look back period on an overcharge claim is not an issue that is susceptible to summary judgment.**

In any event, whether there is a colorable claim of fraud is, inherently, a fact issue, not an issue of law. Therefore, the fraud exception to the four-year look back period on an overcharge claim is not an issue that is susceptible to summary judgment. See *Meyers v. Four Thirty Realty*, 127 A.D.3d 501 (1<sup>ST</sup> Dept. 2015); *Meyers v. Four Thirty Realty, LLC*, 2013 WL 5706827 (Sup. Ct. NY Cty. 2013) (“...there is no bright-line rule regarding the application of the four-year limitations period on overcharge claims. Rather, the Court must make a fact-specific inquiry as to the application of the four-year rule.”); *East 17th LLC v. McCusker*, 51 Misc.3d 142(A) (AT 1st 2016); *Antollino v. Wright*, 2015 WL 5096025 (NY Cty. Sup. Ct. 2015); *Zheng v. Mak*, 2012 WL 978592 (Sup. Ct. NY Cty. 2012); *Morton v. 338 West 46th Street Realty, LLC*, 45 Misc.3d 544 (NYC Civ. Ct. NY Cty. 2014) (“... The burden was not on defendant to show that a four-year statute of limitations applies, but rather, the burden is on plaintiffs to show that the Court should look back beyond the applicable four-year rent history to determine base rent.”); *Davidson v. 730 Riverside Drive, LLC*, 2015 WL 5171072 (NY Cty. Sup. Ct. 2015).

C. **The heightened scrutiny that IAI's are receiving.**

Next, we must consider that IAI's are receiving heightened scrutiny. The new DHCR Operational Bulletin 2016–1 lists the proof that an owner can use to establish IAI's as follows:

Claimed individual apartment improvements are required to be supported by adequate and specific documentation, which should include:

- 1. Cancelled check(s) (front and back) contemporaneous with the completion of the work or proof of electronic payment;**
- 2. Invoice receipt marked paid in full contemporaneous with the completion of the work;**
- 3. Signed contract agreement; and**
- 4. Contractor's affidavit indicating that the installation was completed and paid in full.**

This documentation requirement calls for a higher standard of proof than that found in Policy Statement 90–10 which provided that only one of the above forms of proof was necessary unless DHCR requested additional proof. However, actual processing has shown that more than one type of proof is the norm rather than the exception. Therefore, **an owner should submit as many of the four listed forms of proof as the owner is able to provide with the initial submission/answer.** DHCR's consideration may not be limited to these four items as its review of IAIs is fact intensive and an individualized process regardless of whether it is part of an administrative proceeding or the subject of an independent investigation.

Additionally, IAI review involves DHCR's assessment of the evidence offered so that there is no guarantee that any particular

piece of proof will be dispositive. For example, **an invoice or contract with less than complete specificity may not be sufficient**. DHCR, in every case, has the authority to request information it believes is necessary to reach a proper determination including requests for additional evidence indicating the installation was completed, paid in full and otherwise appropriate to support a rent increase. Additional documentation should at all times be provided if possible, and it should be provided as requested to avoid a more protracted administrative or investigative proceeding. If an owner is unable to provide these items or any item requested, then an explanation must be provided and DHCR will determine whether the proof given is sufficient.

[Emphasis supplied; End of DHCR Op–Bull. Quote.]

It is rare that a landlord actually has their act together to the extent I would like to see it with respect to IAI's. Here are some examples of what I see frequently:

- The cancelled checks do not indicate what invoices were being paid.
- There are no invoices marked “paid”.
- The amounts of certain expenditures do not match up with the invoices.
- The invoices are chronologically discordant with the alleged work.
- Landlord does not provide signed contracts; they have paper, but not contracts.
- Landlord does not provide contractors' affidavits.
- Landlord does not provide before and after pictures of the apartment.

TIP: A simple technique that I always instruct my landlord–clients to engage in is to take before and after pictures, a picture being worth a thousand words (or a thousand invoices, cancelled checks, and contractor's affidavits).

**D. List of factors for a tenant to consider when deciding whether or not to challenge an apartment’s deregulated status based upon an allegation of insufficient IAI’s.**

In light of the foregoing, I have compiled a list of factors for a tenant to consider when deciding whether or not to challenge an apartment’s deregulated status based upon an allegation of insufficient IAI’s:

- (1) If the IAI’s were within four-years, then the case is stronger because there is an overcharge possibility. Next, of course, one must consider how big the overcharge liability would be.
- (2) If the IAI’s were outside of the four-year look back period, you must then evaluate how strong the fraud claim is that will potentially get you beyond the four-years.
- (3) In general, the closer to the present the IAI’s occurred, the stronger the challenge will be. Although the closer to the present the IAI’s occurred, the more likely landlord is to have the proper records.
- (4) If the IAI’s were done by a previous owner, the challenge to the IAI’s will be stronger than if the current landlord was the one who did make the IAI’s. This is true because many landlords do not have a complete copy of a previous owner’s records.
- (5) If the tenant has specific and documented complaints about the apartment that tend to support that the IAI’s did not happen, the challenge to the IAI’s will be stronger. This should be more than just a tenant’s opinion. Here, an expert witness, such as an architect or contractor, is helpful.
- (6) The larger the dollar amount of the alleged IAI’s, the stronger the challenge will be. This is true because the landlord will have more to prove.

## **VI. THE *ALTMAN* CASE WAS OVERRULED!**

On April 26, 2018, *Altman v. West Fourth*, 127 AD3d 654 (1<sup>st</sup> Dept. 2015) was overruled. **Therefore, it is now settled law that an apartment does NOT need a Rent Stabilized tenant to have been actually paying the deregulation threshold rent in order for deregulation to be achieved.**

## **VII. ANALYSIS AND RISK MITIGATION**

### **A. A rent regulatory analysis needs to be expressed in terms of numerical percentages in order to be useful as a risk analysis and mitigation tool.**

A rent regulatory analysis needs to be expressed in terms of numerical percentages in order to be useful as a risk analysis and mitigation tool. Thus, upon completion of my rent regulatory analysis of an apartment, I assign numerical percentages to my findings. This is a Legal Project Management<sup>3</sup> technique for communicating clearly with my clients. For example, I will conclude with something like:

In my opinion, given the information that I have to work with, there is a Sixty-Five Percent (65%) chance that, if tenant challenges the regulatory status of the apartment, then a court or DHCR will find that the apartment is still subject to Rent Stabilization, based upon landlord's inability to support the IAI's. If that happens, then there is a Ninety Percent (90%) chance that an overcharge will be assessed. The overcharge could be between \$10k and \$30k; if trebled, between \$30k and \$90k. I give it a an Eighty Percent (80%) chance that the overcharge will be trebled.

### **B. A CHART!!! AND A CONCLUSION**

Ok now you are in for some real fun – *I MADE YOU A CHART!* And you thought this article couldn't get any better, right?

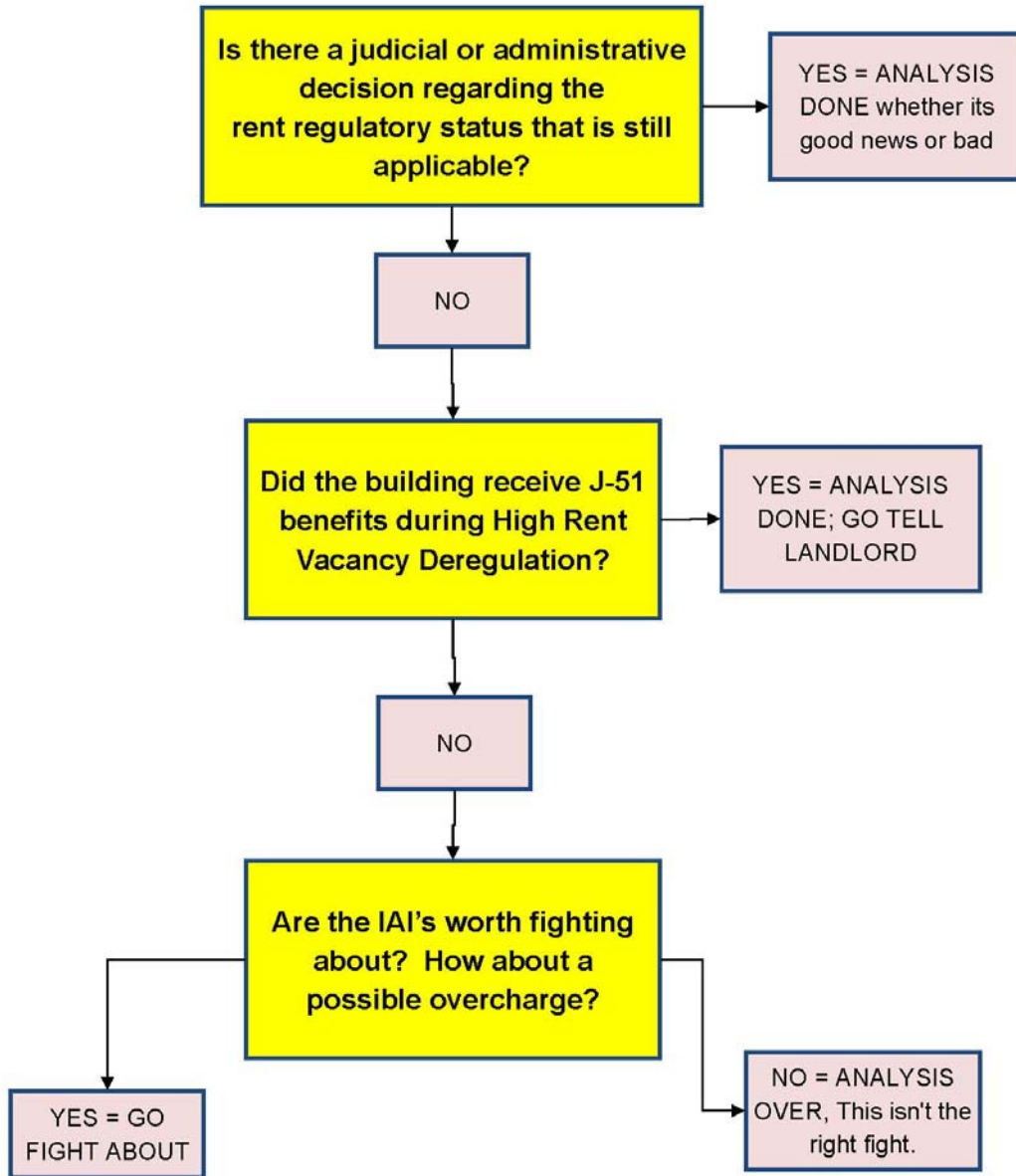
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<sup>3</sup> <http://itkowitzlegalprojectmanagement.itkowitz.com>.

The following chart is tenant-centric. I could have done it either way, and decided that this way was simpler and easier to follow, and the last section was landlord-centric, so I wanted to end on a balanced note.

I estimate that between J-51, faulty IAI's, and 421-a and illegal SRO's (not covered in this article), there are probably a quarter million improperly deregulated apartments out there. It's likely that most of us can't wait for the legislature, the courts, the DHCR, the landlord advocacy organizations, or tenancy advocacy organizations to fix it. How's any of that working out for you so far? Each person, be they landlord or tenant, needs to take responsibility for seeking understanding about the rent regulatory status of the apartments they own or live in. I, the purveyor of one woman-owned, small, private law firm, do not portend to have the ultimate answer to this crisis. And it is a crisis. I only know this – there can be no solutions without understanding.

IS YOUR FREE MARKET APARTMENT STILL SUBJECT TO RENT STABILIZATION? Copyright Michelle Itkowitz 2016 (Charts are fun!)



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## ABOUT THE AUTHOR

Michelle Maratto Itkowitz is the owner of Itkowitz PLLC. She practices real estate litigation. Michelle has over twenty years of experience, and is best known for her work in the area of commercial and complex–residential landlord and tenant law in the City of New York. Michelle represents BOTH landlords and tenants and her core competencies include: Rent Stabilization and Rent Control, the Loft Law, Short–Term Leasing cases, Yellowstone injunctions, tenant buyouts, clearing buildings so that construction projects can go forward, and Rent Stabilization Due Diligence. She also is very experienced in general commercial litigation.

Michelle publishes and speaks frequently on legal issues in real estate. The groups that Michelle has written for and/or presented to include: Lawline.com; The Columbia Society of Real Estate Appraisers; LandlordsNY; Lorman Education Services; Rossdale CLE, The Association of the Bar of the City of New York; The New York State Bar Association, Real Property Section, Commercial Leasing Committee; Thompson Reuters; The Cooperator; The New York State Bar Association CLE Publications; The TerraCRG Brooklyn Real Estate Summits; The Association of the Bar of the City of New York; BisNow; and SubletSpy.

Michelle regularly creates and shares original and useful content on real estate and law, including booklets, videos, and articles. She is frequently quoted in the press on a variety of real estate and legal issues. As the “Legal Expert” for LandlordsNY.com, the first social platform exclusively for landlords and property managers, Michelle answers member's questions, guest blogs, and teaches. Michelle recently developed a seven–part, eight–hour continuing legal education curriculum for Lawline.com entitled "New York Landlord and Tenant Litigation". Over 16,000 lawyers have purchased Michelle and Jay Itkowitz's earlier CLE classes from Lawline.com, and the programs have met with the highest reviews.

Michelle is immensely proud that Itkowitz PLLC was recently awarded its NYS Women Business Enterprise Certification by the Empire State Development Corp.

Michelle is admitted to practice in New York State and the United States District Court for the Southern District of New York. She received a Bachelor of Arts in Political Science in 1989 from Union College and a Juris Doctor in 1992 from Brooklyn Law School. She began her legal career at Cullen & Dykman.

There are many ways to keep up with Michelle. When Michelle tweets, which is not an obnoxious amount, she does so in an easy to understand manner about useful stuff regarding real estate, business, the legal industry, and organic herb gardening. Feel free to contact Michelle; she would be happy to speak to you.



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