



# Closing the Books

November 30, 2021

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# You Win Some, You Lose Some: The Second Circuit Affirms Dismissal of Landlords' Free Speech Challenge to Harassment Laws and Reverses Dismissal of Landlords' Contract Clause Challenge to Guaranty Law

November 30, 2021



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On October 28, 2021, the United States Court of Appeals for the Second Circuit ruled on *Melendez v. City of New York*, in which the plaintiffs, who are New York City landlords, alleged that certain laws enacted in response to the COVID-19 pandemic were unconstitutional. First, the plaintiffs alleged that the amendments to the City's Residential and Commercial Harassment Laws (the "Harassment Law") that prohibit "threatening" tenants based on their status as COVID-19 impacted businesses or persons violate the plaintiffs' free speech rights by restricting commercial speech in the routine collection of rents and further violate their due process rights by not providing fair notice of what constitutes "threatening" conduct. Additionally, the plaintiffs alleged that the "Personal Liability Provisions in Commercial Leases" law (the "Guaranty Law"), which renders unenforceable personal liability guaranties of commercial lease obligations arising between March 7, 2020, and June 30, 2021, violates the Contracts Clause. The United States District Court for the Southern District of New York dismissed both of the plaintiffs' constitutional challenges. The Second Circuit, however, concluded that while the plaintiffs failed to allege plausible free speech/due process claims, they did allege a plausible Contracts Clause challenge to the Guaranty Law, and, as a result, their Contracts Clause claim should not have been dismissed in the lower court.

Effective May 26, 2020, the Harassment Law prohibits threatening any lawful residential occupant "based on such person's actual or perceived status as an essential employee, status as a person impacted by COVID-19, or receipt of a rent concession or forbearance for any rent owed during the COVID-19 period." Violations could result in fines of \$2,000 to \$10,000. The Harassment Law also prohibits threatening a lawful commercial tenant based on such tenant's "status as a person or business impacted by COVID-19 or . . . receipt of a rent concession or forbearance for any rent owed during the COVID-19 period" with fines for violations ranging from \$10,000 to \$50,000.

Also effective May 26, 2020, the Guaranty Law pertains to leases held by commercial tenants who were required to cease or limit operations under certain Executive Orders issued in response to the pandemic. The Guaranty Law releases a guarantor from its obligations on such commercial leases and applies retroactively to rent arrears dating from March 7, 2020, and prospectively through June 30, 2021, regardless of the financial circumstances of the tenant, guarantor, or the landlord. The Court noted that the Guaranty Law does not defer a landlord's ability to enforce a personal guaranty, but "forever extinguishes it."

The district court granted the defendants' motion to dismiss for failure to state a claim. With respect to the commercial Harassment Law, the district court reasoned that nothing in the laws prevented landlords from communicating with tenants about past-due rent and pursuing available remedies to either collect rent or repossess their property. As for the residential Harassment Law, the district court concluded that demands for rent in the ordinary course of business were not prohibited, pointing to New York case law that distinguished "improper threats" from "permissible warnings of adverse but legitimate consequences" for non-payment of past-due rent. Finally, with respect to the Guaranty Law, the district court concluded that although the plaintiffs plausibly alleged a substantial impairment of their contract rights, dismissal was warranted because the Guaranty Law advances a legitimate public purpose and is a reasonable and necessary response to a "real emergency."

The Second Circuit upheld the dismissal of the challenges to the Harassment Law. It agreed with the district court that the relevant statutory text, viewed in context and as construed by New York courts, does not support the construction that landlords are prohibited from making reasonable, lawful demands for the payment of past-due rent. However, the Second Circuit disagreed with the district court that the challenge to the Guaranty Law can be dismissed as a matter of law. It applied the same three-part balancing test as the district court: (1) whether the challenged law substantially impairs plaintiffs' commercial leases; (2) whether, nevertheless, the impairment serves a significant and legitimate public purpose, and (3) whether the challenged law is appropriate and reasonable to advance that purpose. The district court found the answer to be "yes" to all three prongs.

The Second Circuit also concluded that the Guaranty Law significantly impairs the plaintiffs' contracts because it appears to permanently render unenforceable commercial lease guaranties for arrears arising over a 16-month period.

Further, relying on precedent that mitigation of economic emergencies as a public purpose can support contract impairment, the Court concluded that because the City asserted a legitimate public purpose (*i.e.*, to mitigate the economic emergency in New York City resulting from the COVID-19 pandemic) that appears at least plausible on the pleadings record, the Court must conduct further inquiry. However, the Court disagreed with the district court at the last step, finding that the plaintiffs pleaded sufficient facts to preclude a court from finding as a matter of law that the Guaranty Law is a reasonable and appropriate means to serve the City's public purpose. The Court reasoned that the totality of five features of the Guaranty Law precludes dismissal of the Contracts Clause claim: (1) the Guaranty Law is not a temporary or limited impairment of contract; (2) the Court cannot conclude as a matter of law that the Guaranty Law is an appropriate means to achieve its proffered purpose of "help[ing] shuttered small businesses survive the pandemic so that they can reopen after the emergency, ensuring functioning neighborhoods throughout the City"; (3) the Guaranty Law allocates the economic burden not to the public but to a discrete group of private persons: commercial landlords; (4) the relief is not conditioned on need but rather extinguishes the obligations of guarantors for up to 16 months of rent arrears regardless of their ability to pay, raising reasonableness concerns; and (5) the reasonableness of the Guaranty Law is also called into question by the law's failure to provide for landlords to be compensated for damages or losses sustained as a result of their guaranties' impairment. Thus, the Court ruled that it cannot conclude as a matter of law that the Guaranty Law is a reasonable and appropriate means to serve the public purpose so as to warrant dismissal of the claim. The Court made sure to note, however, that it would be premature for it to declare the Guaranty Law unconstitutional as a matter of law. Thus, the Court remanded the case to the district court.

We will keep you apprised of any further developments.

# The UK's Autumn Budget 2021: Implications for Real Estate

November 30, 2021



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As we draw close to the end of the year, we take a moment to revisit some of the taxation changes announced in the Autumn budget, with some of these being implemented in the upcoming tax year in April 2022. Set out below are items which we think are of most interest to Cadwalader's clients in the real estate industry. Readers can also refer to our [memo](#) published on 28 October 2021 for discussions on other tax measures.

## New Tax Regime for Asset Holding Companies

As part of the Government's wider review of the UK funds regime to boost the UK's competitiveness as a location for asset management, the Government will legislate to introduce a bespoke tax regime for qualifying asset holding companies ("QAHC"). This regime targets UK resident intermediate holding companies interposed between investors and underlying assets. The taxation in the new regime is based on existing UK tax rules but with some targeted modifications to address specific tax barriers which are considered to have discouraged the market from establishing asset holding companies in the UK.

The Government has conducted two consultations on this regime, and published on 20 July 2021 its response to the second-stage consultation, accompanied by some of the draft legislation which will be required for the operation of the new regime. The draft legislation prescribed a robust set of eligibility criteria to limit accessing the new regime's benefits to the intended users only, requiring a QAHC to be at least 70 percent owned by diversely owned funds or certain institutional investors, and to carry out investment activity with no more than insubstantial ancillary trading. Also, the benefits of the proposed regime will be applicable to the QAHC's investment activity only in respect of certain asset classes, such as non-UK land, certain shares and loans, and any derivative contract in relation to any asset previously mentioned.

Under the draft legislation and the accompanying policy paper, these benefits will include certain modifications to the corporation tax rules (such as allowing deductions for interest payments on certain profit-participating and results-dependent loans, exempting gains on disposal of certain shares and non-UK property, and exempting profits of a QAHC's non-UK property business, where those profits are subject to tax in a non-UK jurisdiction), withholding tax rules (by exempting withholding in relation to interest in respect of securities held by investors in that QAHC), and stamp taxes rules (by exempting repurchases by a QAHC of share and loan capital which it previously issued from stamp duty and stamp duty reserve tax).

The Budget confirms that this regime is intended to be legislated in Finance Bill 2021-22, and refers to the two consultations and the draft legislation. The policy paper in the Budget sets out further benefits that a QAHC will enjoy under the regime (in addition to those mentioned in the policy paper published on 20 July 2021). These additional benefits include exempting the associated profits that arise from loan relationships and derivative contracts and allowing certain amounts paid to certain "non-domiciled" residents by a QAHC to be treated as non-UK source when such individuals claim the remittance basis for the purposes of UK income tax and capital gains tax.

The publications accompanying the Autumn Budget do not include a full suite of revised draft legislation for the QAHC regime. It therefore remains to be seen what further legislative changes will be made in respect of the points still being considered by the Government in accordance with its response to the second-stage consultation in July 2021 and the additional modifications mentioned in the Budget. In relation to the value added tax ("VAT") treatment of fund management fees, the Government has announced in the Autumn Budget that it will consult on options to simplify the

VAT treatment of fund management fees, a critical remaining piece in the regime before a successful launch can be achieved.

### **Real Estate Investment Trusts (“REITs”)**

Responses to the asset holding company consultation in relation to investments in real estate led to proposals for changes to the REIT regime. With effect from 1 April 2022, the Government has announced that amendments will be made to the rules applying to REITs, including by relaxing or removing some of the conditions which determine whether a company qualifies to be a UK REIT.

Among other things, the proposed changes remove the requirement for REIT shares to be admitted to trading on a recognised stock exchange where institutional investors hold at least 70 percent of the ordinary share capital in the REIT, remove the “holders of excessive rights” charge where property income distributions are paid to investors entitled to gross payment, and introduce a new simplified “balance of business” test so that a REIT may not be required to prepare the additional statements required where the full test is otherwise met.

These amendments will no doubt be welcomed by the real estate investment sector, and will alleviate certain constraints and administrative burdens, thus further enhancing the attractiveness of the UK REIT regime.

### **Residential Property Developer Tax (“RPDT”)**

The Government consulted on the policy design of the new Residential Property Developer Tax (“RPDT”) and conducted a technical consultation on the draft legislation during 2021. In Budget 2021, the Government confirmed the introduction of the RPDT with effect from 1 April 2022 for companies or groups of companies undertaking UK residential property development with annual profits in excess of £25 million. The Government announced in Budget 2021 that the rate of the RPDT would be 4 percent. The £25 million allowance can be allocated by the group between its companies.

Whilst hypothecated taxes are not a common feature of the UK tax system, revenues raised from the RPDT are intended to be used to fund cladding remediation and, thus, the RPDT is expected to be a time-limited tax. However, the draft legislation does not include a sunset clause, and respondents to the consultations noted that the expected revenues raised (expected to be £2 billion over a 10-year period) may be insufficient.

Non-profit housing developers and build-to-rent developers have been excluded from the scope of the RPDT.

Companies and groups engaging in residential property development will need to give careful consideration to the activities within scope and any reliefs (such as in respect of loss relief or group relief) which may be available.

## Recent Transactions

November 30, 2021

Here is a rundown of some of Cadwalader's recent work on behalf of our clients.

Recent transactions include:

- Represented Morgan Stanley in connection with its \$670 million loan to RXR Realty LLC for 230 Park Avenue, known as the Helmsley Building, in Midtown Manhattan.
- Represented the lender in the acquisition financing of a dormant mixed use property in Pasadena, California, including future advances for hard costs, capital expenditures, tenant improvement and leasing costs for re-tenanting the property.
- Advised the lenders in a \$805.9 million securitized mortgage loan to finance Equus Capital Partners' \$1.15 billion acquisition of 74 industrial properties from Reliance Management.
- Represented the lender in connection with a \$217.5 million refinancing of the Gurney's Resort and Seawater Spa, a full-service luxury beachfront resort located in the Hamptons.