Clients&FriendsMemo

COVID-19 Update: We're All in This Together, but Landlords Are About to Take a Bath – SDNY Upholds Constitutionality of NYC's Guaranty and Tenant Harassment Laws

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As the COVID-19 pandemic unfolded upon New York City, policymakers grappled with impossible decisions regarding how to protect public health and stave off economic ruin for individuals, businesses and the economy at large. Among a slew of executive orders, administrative orders and statutes enacted at all levels, New York City passed three ordinances that received particular scrutiny.

The first such ordinance is known as the "Residential Harassment Law," which prevents residential landlords from harassing residents impacted by COVID-19 out of their homes. The second ordinance is known as the "Commercial Harassment Law" (together with the Residential Harassment Law, the "Harassment Laws") and similarly prevents commercial landlords from harassing tenants out of their properties. The Harassment Laws were designed to protect, among others, those diagnosed with COVID-19, caretakers of those with COVID-19, essential workers, those who lost employment, businesses that closed and those who took on additional financial responsibilities as a result of COVID-19.

The Harassment Laws were structured as amendments to pre-COVID-19 ordinances and operated to expand the scope of such laws to address the concerns related to the pandemic. The existing Residential Harassment Law defines harassment as "any act or omission by or on behalf of an owner that (i) causes or is intended to cause any person lawfully entitled to occupancy of a dwelling unit to vacate such dwelling unit or to surrender or waive any rights in relation to such occupancy." The ordinance enumerates certain acts such as changing the locks without consent and repeated failure to correct hazardous housing code violations. The post-COVID-19 amendment expanded the definition of harassment by adding a new form: "threatening any person lawfully entitled to occupancy of such dwelling unit 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."

The previously existing Commercial Harassment Law defines "harassment" as "any act or omission by or on behalf of a landlord that (i) would reasonably cause a commercial tenant to vacate covered property." The post-COVID-19 amendment expanded such definition by adding a new form: "threatening" a commercial tenant based on "the commercial tenant's status as a person or business impacted by COVID-19, or the commercial tenant's receipt of a rent concession or forbearance for any rent owed during the COVID-19 period." The Commercial Harassment Law, however, included a provision that the Residential Harassment Law did not. A savings clause was added which provides that a "landlord's lawful termination of a tenancy, lawful refusal to renew or extend a lease or other rental agreement, or lawful reentry and repossession" cannot constitute "commercial tenant harassment." Further, it also states that none of the ordinance's provisions relieves a commercial tenant "of the obligation to pay any rent for which the commercial tenant is otherwise liable."

The third ordinance, known as the "Guaranty Law," prevents commercial landlords from enforcing a personal guaranty in order to recover losses incurred between March 7, 2020 and March 31, 2021 – indefinitely. Unlike a moratorium on enforcement whereby one would merely have to wait until the moratorium period expired before seeking recourse, a landlord will never be able to recover, under a personal guaranty, amounts unpaid during such one-year period.

The Guaranty Law, however, does not apply to all guaranties. As a threshold matter, only personal guaranties executed by natural persons other than the tenant fall within the purview of the Guaranty Law. Corporate guarantors are not entitled to relief. Second, such guaranties must have been given on behalf of tenants that (a) were required to cease serving patrons food or beverage for on-premises consumption or to cease operation under executive order 202.3 issued by the governor on March 16, 2020; (b) were non-essential retail establishments subject to in-person limitations under guidance issued by the New York state department of economic development pursuant to executive order number 202.6 issued by the governor on March 18, 2020; or (c) were required to close to members of the public under executive order number 202.7 issued by the governor on March 19, 2020. Finally, the default or other event causing such guarantor to become personally liable must have occurred between March 7, 2020 and March 31, 2021.

Plaintiffs, who own small commercial and residential buildings in Brooklyn, Queens and Manhattan, filed proceedings in the Southern District of New York alleging that the laws cause severe economic harm, and that the Harassment Laws produce a chilling effect on their efforts to collect rent in the ordinary course of business for fear that tenants will accuse them of harassment. Plaintiffs argued that such laws are unconstitutional on the grounds that they violate the right to free speech, the right to due process and the Contract Clause.

Plaintiffs argued that the Harassment Laws "chilled" them from communicating with delinquent tenants about past-due rent and pursuing available remedies to either collect that rent or to

repossess their property, therefore violating their right to free speech. One plaintiff indicated that they ceased all demands for past-due rent out of fear that they would be accused of harassment. The Court found that routine demands for rent are beyond the purview of the Harassments Laws. In doing so, the Court placed its trust in the justice system to "distinguish between improper threats or coercion and permissible warnings of adverse but legitimate consequences," stating that "[i]nforming a tenant that she will be obligated to vacate her home if she fails to make the payments for which she contracted is not the same thing as—for example—commencing repeated frivolous court proceedings against her."

The Court acknowledged that the enactment of the Guaranty Law was entirely unforeseeable and that such law imposes a substantial impairment to plaintiffs' contracts, thus meeting one of three requirements necessary to constitute a violation of the Contract Clause. The Court went on to determine that the remaining two requirements were not met. That is, the Guaranty Law (i) advanced a legitimate public interest, and (ii) was reasonable and necessary to advance such public interest. In determining the latter prong, the Court cited its extreme deference to policymakers seeking to advance a legitimate public interest. Furthermore, in determining the Guaranty Law's reasonableness, the Court highlighted the fact that landlords had other avenues of seeking recourse in order to recover the losses incurred during the covered period, such as suing the tenant for unpaid rent, charging late fees, terminating possession and eviction. The Court, however, admitted that such means may not be adequate for commercial tenants who have gone out of business and have little to no remaining assets.

The Court was sure to temper the issue by honoring and appreciating the substantial harm to plaintiffs and others affected. In the end, the Court, weighing plaintiffs' legitimate concerns and economic hardship against the interest of the public good, upheld each of the Harassment Laws and the Guaranty Law. The Court found that (i) the Harassment Laws do not prevent landlords from making routine rent demands and therefore do not violate free speech rights; (ii) the Harassment Laws are sufficiently clear regarding what constitutes harassment and therefore do not violate due process; and (iii) the Guaranty Law does not violate the Contract Clause, as the Court gives broad deference to policymakers legislating in the interest of the public good.

However laudable these various laws are in these unprecedented times, it is still unclear how a small landlord which relies on its tenants as its only source of revenue to run its "small business" – that being its small commercial and/or residential building – is supposed to be able to remain in business and pay its bills, including its mortgage. While our elected officials have been quick to provide relief to tenants during the pandemic, this is not solely a tenant issue. This policy, which aims to shift the financial burden to well-capitalized landlords and protect certain small business owners, may instead end up affecting a large number of small landlords – and their supporting financial institutions – as an unintentional result. When one cog in the economic wheel is altered, it

has wide-reaching ripple effects throughout. We're all in this together, but landlords and lenders are about to take a bath.

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If you have any questions, please feel free to contact either of the following Cadwalader attorneys.

Steven Herman	+1 212 504 6054	steven.herman@cwt.com
Parker Ihrie	+1 704 348 5158	parker.ihrie@cwt.com