Appellate and Supreme Court Practice
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# Second Circuit Decision Revives Landlord's Fight for Rights amid Pandemic Ordinances

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The Second Circuit Court of Appeals issued a potentially far-reaching decision reviving New York City's commercial landlords' fight against a sweeping ordinance enacted to combat the COVID-19 pandemic's economic effects, though possibly creating precedent for future local, state and federal government responses to economic and other crises.

New York recently passed the so-called "Guaranty Law," which forbids commercial landlords from enforcing "personal liability guarantees" for the 16 month period when the city was under some form of COVID-19 executive order if the order had the effect of limiting business occupancy, mandating social distancing, or otherwise restricting operations.[i] Landlords argued the ordinance "re-writes [landlord's] contracts with their tenants, stripping [them] of remedies to enforce personal guarantees that were a material benefit of" the contracts.[ii] The guaranty agreements make a third party – generally the owner of the business (though this isn't a requirement) – personally liable for rent that the business fails to pay. However, under the law enacted by the New York City Council, such agreements are void for any rent not payed between March 7, 2020 and June 30, 2021.[iii] The law's purpose, as determined by the Second Circuit, was to help small business owners recovering from economic losses due to the pandemic and allow them to recover without the threat of being wiped out by personal debt, which threatened to create "ghost towns" in neighborhoods which could take years to recover.

The landlords challenged the law on the grounds that it violated their rights to privately contract. The District Court for the Southern District of New York applied a three-part test to determine (1) whether the law substantially impaired the plaintiff's contract rights, (2) whether the law serves a significant and legitimate public purpose, and (3) whether the law is appropriate and reasonable to advance the purpose.[iv] The district court found that the plaintiffs' contract rights *were* substantially altered. However, it also found that the law served a significant and legitimate public interest, and did so in an appropriate and reasonable manner. Thus, the landlords failed to state a claim on which relief could be granted and the case had to be dismissed.

While not reaching a judgment on the merits or constitutionality of the law – which the plaintiffs asked the Second Circuit to do[v] – the Court of Appeals did reverse the dismissal and find that the question of whether the law was appropriate and reasonable "cannot now be decided in defendants' favor as a matter of law."[vi] Because of this, "the plaintiffs' Contracts Clause claim cannot be dismissed"[vii] without further proceedings.[viii] The Court of Appeals raised five major concerns regarding the reasonability of the law, which may provide analytical framework both for laws dealing with this crisis, and the next:

First, the Guaranty law permanently enjoins the landlords from exercising their contract rights. In other cases where the Supreme Court had previously found a law reasonable, the law in question granted temporary relief but left the "integrity" of the contract unimpaired.[ix] While the Court noted that "permanent impairment of contract [rights] can [] be deemed reasonable or appropriate" permanent deprivation "weigh[s] heavily against a finding of reasonableness, particularly at the pleadings stage."[x]

Second, it granted relief to guarantors of the rent regardless of whether the guarantors owned the

shuttered businesses, or if the businesses ever reopened.[xi] While granting relief to business owners who reopened or were in the process of reopening their businesses, third parties who did not rely on those businesses or business owners with no intention of reopening their storefronts may have been receiving unnecessary relief. While the court will often defer to legislative judgments about reasonable means of addressing crises, such as economic relief for small business owners, "such deference is not warranted in the absence of some record basis to link purpose and means" which was "lacking in the record we review on this challenge to dismissal pursuant to Rule 12(b)(6)."[xii]

Third, the law shifts the cost of a "public good" (preserving the small business community) to the shoulders of the landlords of the city, but not the broader community which would enjoy the benefits of that "good." The court noted that in previous cases, it had struck down statutes which funded the public purpose by placing the burden on the shoulders of a few "instead of the many shoulders of the citizens of the [jurisdiction]."[xiii] The Guaranty Law did not afford relief by "appropriating existing funds or raising taxes so as to place the burden of preserving neighborhoods on the citizenry that would benefit… [but rather] transferred the burden to the few shoulders of commercial landlords."[xiv]

Fourth, while other pandemic relief laws conditioned relief on need, the Guaranty Law does not. The law does not distinguish between those who can and cannot afford to pay on the guarantee agreement. Further, while the legislature is entitled to create law based on "the general or typical situation" there must be evidence "to compel a conclusion" that one party would be better situated to bear the burden than another.[xv] Here, there was nothing in the record to demonstrate "that a particular landlord is better able than a particular guarantor to bear the financial burden of a tenant's inability to pay rent."[xvi]

And finally, the law fails to compensate landlords for damages or losses, and "[o]n the present record, we must assume [] such damages can be extensive."[xvii] While not dispositive, the Court noted that in other instances where Courts have found contract impairments to be valid, those affected by the law were generally offered some form of compensation.[xviii]

Judge Carney's dissent took issue with the majority's "sliding-scale" approach, under which broader intrusions into contractual rights received more exacting scrutiny. In the dissent's view, this approach delved too far into whether a law is "wise or unwise as a matter of policy [which] is a question with which [courts] are not concerned."[xix] The dissent would have found the Guaranty Law reasonable as a matter of law because it was narrowly tailored: it applied only to small businesses affected by shutdown orders for the time period those orders were active. Hence, the law "passes the low threshold posed by step three of the modern Contracts Clause analysis for laws impairing private contracts."[xx]

This case's impact could be widespread not only for parties directly impacted by COVID-19 related laws which affected their contract rights, but more broadly as to how courts look at government actions regarding landlords' leases to future crises. As it makes its way back down to the District Court, the role the considerations above play will be closely followed. Please contact us if you have any questions about this quickly developing area.

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[i] *Melendez et al v. City of New York et al*, No. 20-4238 Opinion at 19 (hereinafter "Opinion").
[ii] *Melendez et al v. City of New York et al*, No. 1:20-cv-05301-RA (S.D.N.Y.), Complaint ECF No. 1, at ¶ 8.
[iii] Opinion at 36.
[iv] *See id.* at 47; *see also Sveen v. Melin*, 138 S. Ct. 1815, 1821-22 (2018); *Energy Rsrvs. Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411-12 (1983); *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-45 (1978).
[v] Opinion at 107.
[vi] *Id.* at 91.
[vii] *Id.*
[viii] The Court did affirm the District Court's dismissal of two other claims challenging two other ordinances on First Amendment and Fourteenth Amendment grounds.
[ix] *Home Bldg. & Loan Assoc. v. Blaisdell*, 290 U.S. 398, 445 (1934).
[x] Opinion at 92-93.
[xi] Id. at 95-96.
[xii] *Id.*
[xiii] *Id.* at 98.
[xiv] *Id.*
[xv] *Id.* at 102, citing *Blaisdell*, at 445.
[xvi] *Id.* at 100.
[xvii] *Id.* at 105.
[xviii] *Id.*, citing *Blaisdell*, at 445.
[xix] Dissenting Opinion at 35.
[xx] *Id.* at 33.