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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

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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.