

New York Law Journal

Real Estate Trends

WWW.NYLJ.COM

VOLUME 266—NO. 105

An ALM Publication

WEDNESDAY, DECEMBER 1, 2021

RENT STABILIZATION

Could NY's Guaranty Law Be Found Unconstitutional?



By
Warren A.
Estis

In our June 2020 column, we raised various potential infirmities affecting Intro 1932-2020 (the “Guaranty Law”), which, *inter alia*, prohibited the enforcement of personal guaranties executed in connection with certain commercial leases. Signed into law by Mayor Bill DeBlasio on May 26, 2020, the Guaranty Law (as subsequently renewed and extended) permanently barred the enforcement of guaranties within its scope for the period from March 7, 2020 through and including June 30, 2021.

Among the issues we raised at that time was the Guaranty Law’s potential violation of the U.S. Constitution’s Contracts Clause, which states: “No state shall...pass any...law impairing the obligation of contracts.” U.S. Const. art. I, § 10, cl. 1. Our column concluded: “Given its total suspension of certain guaranty obligations, judicial review of this

new law—in which one or more of the above arguments may be considered—seems inevitable.”

Sure enough, soon thereafter the Guaranty Law was challenged in federal court on constitutional grounds. While the U.S. District Court dismissed the challenge, the U.S. Court of Appeals for the Second Circuit has reversed the dismissal in part, thus raising the distinct possibility that the Guaranty Law could ultimately be struck down and that the obligations shielded from liability under it could become enforceable.

In *Melendez et al. v. City of New York et al.*, a group of New York City owners commenced an district court action for a judgment declaring the Guaranty Law unconstitutional and for an injunction permanently enjoining its enforcement. On Nov. 30, 2020, the District Court (1) granted the defendants’ motion to dismiss the plaintiffs’ amended complaint in its entirety for failure to state a claim, and (2) denied the plaintiffs’ motion for preliminary injunctive and

declaratory relief without review. *See Melendez v. City of New York*, 503 F Supp 3d 13 (SD NY 2020), *affd in part, vacated in part, revd in part*, 16 F4th 992 (2d Cir 2021).

In evaluating a Contracts Clause claim, courts assess whether the challenged law (1) substantially impairs the plaintiff’s contract rights, (2) advances a significant and legitimate public purpose, and (3) constitutes a reasonable and appropriate means to advance that public purpose. *See Sveen v. Melin*, 138 S Ct 1815, 1821-1822 (2018). The District Court concluded that dismissal was warranted because (1) while the plaintiffs plausibly alleged a substantial impairment of their contract rights, the Guaranty Law (2) advanced a significant and legitimate public purpose and (3) was an appropriate and reasonable means to advance that public purpose. *See Melendez*, 503 F Supp 3d at 31-36.

However, in an Oct. 28, 2021 opinion by Circuit Judge Reena Raggi and joined by Circuit Judge Jose Cabranes, with Circuit Judge

WARREN A. ESTIS is a founding member at Rosenberg & Estis. ALEXANDER LYCOYANNIS is a former member at the firm.

Susan Carney filing a separate opinion concurring in part and dissenting in part, the Second Circuit (while affirming the dismissal of certain amendments to the tenant harassment laws) reversed the District Court's dismissal of the plaintiffs' Contracts Clause challenge to the Guaranty Law, vacated the denial of preliminary injunctive and declaratory relief, and remanded the case to the District Court. *Melendez v. City of New York*, 16 F4th 992 (2d Cir 2021).¹ (Please note that page citations hereafter will be to the copy of the decision available on the Second Circuit's website; as of this writing, page citations to the officially reported decision are unavailable.)

The Second Circuit agreed with the District Court that the Guaranty Law substantially impairs owners' rights: "Under the Guaranty Law, if a tenant fails to pay rent owed for any time between March 7, 2020, and June 30, 2021, the landlord can never seek to recover those amounts from the guarantor. Not during the pandemic period. Not after the emergency declaration is withdrawn. Not ever. This substantially undermines the landlord's contractual bargain, interferes with his reasonable expectations, and prevents him from safeguarding or ever reinstating rights to which he was entitled during a sixteen-month period." *Melendez* at 80.

The Second Circuit also agreed with the District Court that the Guaranty Law advanced a

significant and legitimate public purpose. The court found decisive (1) the April 29, 2020 statement of Councilmember Carlina Rivera, who explained that she sponsored Intro 1932 in order to "ensure that business owners, should they be forced to walk away or temporarily shutter their stores, through no fault of their own," are able to do so

With the Second Circuit's ruling, it is foreseeable that the Guaranty Law's enforcement could be stayed and that the plaintiffs and other New York City owners will be able to enforce contractual rights believed to have been lost forever.

"without facing personal liability, ensuring that one day they may be able to return and relaunch or create a new thriving business in our neighborhoods," and (2) legislative text stating that the Guaranty Law served to minimize "economic and social damage caused to the city" by the COVID-19 pandemic, which "will be greatly exacerbated and will be significantly worse than if these businesses are able to temporarily close and return or, failing that, to close later, gradually, and not all at once." *Melendez* at 86-87.

However, while agreeing with the District Court's conclusions regarding the first two steps of the Contracts Clause analysis, the Second Circuit "[did] not reach

the same conclusion at the last step." *Melendez* at 47. The court identified five factors leading to its conclusion that the Guaranty Law was not an appropriate and reasonable means to advance the law's stated purpose.

Not a Temporary or Limited Contract Impairment. The court held that unlike in cases where laws survive Contracts Clause challenges, the Guaranty Law does not effect a "temporary" or "limited" impairment of contract. Rather, "for rent arrears arising during th[e Guaranty Law's] almost sixteen-month period, the Guaranty Law does not simply defer a landlord's ability to enforce a personal guaranty; it forever extinguishes it." *Melendez* at 24.

Guarantors Achieve Full Relief Without Furthering Guaranty Law's Public Purpose. The court also held that—at least at the pleadings stage—it could not conclude that the Guaranty Law "is an appropriate means for achieving its professed public purpose: to help shuttered small businesses survive the pandemic so that they can reopen after the emergency, ensuring functioning neighborhoods throughout the city." *Melendez* at 95. The court found that the benefits afforded to guarantors did not line up with such purpose:

The problem with concluding that the Guaranty Law is an appropriate means to serve this public purpose is that the law does not condition the

relief it affords on guarantors owning shuttered businesses or, even if they do, on their ever reopening those businesses. Rather, guarantors receive the full relief afforded by the Guaranty Law even if they never reopen (or intend to reopen) their businesses. In short, the Guaranty Law permanently excuses guarantors from pandemic-accrued rent liability even in circumstances where they do nothing to serve the public interest in generally ensuring functioning neighborhoods.

Id. at 95-96.

Misallocation of Economic Burden. Further, the Second Circuit cited the misallocation of the Guaranty Law's economic burden upon owners. "[T]he City did not afford Guaranty Law relief by appropriating existing funds or raising taxes so as to place the burden of preserving neighborhoods on the citizenry that would benefit therefrom." *Melendez* at 98. Rather, this relief came "at the expense of a discrete group of private persons: commercial landlords." *Id.* at 97. In contrast to laws surviving Contracts Clause challenges where "the burden of contractual impairment [is] tailored to the party causing the public harm that the state sought to mitigate," the Court noted that the defendants "do not argue that landlords are in any way responsible for the economic problem that the Guaranty Law seeks to address." *Id.* at 99.

Relief Under Guaranty Law Not Conditioned on Need. The Second Circuit also noted that relief under the Guaranty Law is not conditioned on need, a factor which the Supreme Court found significant in at least two successful Contracts Clause challenges. *See Melendez* at 100. The Court contrasted this aspect of the Guaranty Law with the "[m] any forms of pandemic financial relief [which] are conditioned on individual applicants demonstrating need or hardship," such as the relief afforded by the CARES Act, the American Rescue Plan's Restaurant Revitalization Fund, and New York State's statutory eviction moratoria. *Id.* at 101.

No Damages or Losses to Owners by Reason of Guaranties' Impairment. Finally, the Second Circuit noted that the Guaranty Law provides for no mechanism to compensate owners for losses sustained by reason of their guaranties' impairment—another factor on which prior Contracts Clause challenges have turned. *See Melendez* at 105.

The Second Circuit remanded *Melendez* for further proceedings, including, without limitation, the consideration of the plaintiffs' motion for a preliminary injunction and declaratory relief. Notably, the court's decision came in connection with a motion to dismiss, so the Guaranty Law remains in effect and the plaintiffs' claims must be adjudicated on the merits.

However, in considering the plaintiffs' preliminary injunction

motion, the District Court must assess the plaintiffs' likelihood of success on the merits of their claims. With the Second Circuit's ruling, it is foreseeable that the Guaranty Law's enforcement could be stayed and that the plaintiffs and other New York City owners will be able to enforce contractual rights believed to have been lost forever. The New York real estate industry will, of course, be watching the *Melendez* proceedings closely.

.....●.....

1. Our colleague Jeffrey Turkel submitted an amicus brief to the Second Circuit on behalf of the Rent Stabilization Association of NYC, Inc. and the Community Housing Improvement Program.