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REAL ESTATE ADVISORY

NYC Law Renders Some Commercial Lease Guarantees Unenforceable

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KEY POINTS

- Under the newly enacted law Int. No. 1932-A, the New York City Administrative Code was amended to render unenforceable, in certain instances, the personal liability of guarantors of payment obligations contained in commercial leases of New York City real property.

- In order for such personal liability to be unenforceable, each of the following must be satisfied:
  - The guarantor must be a natural person who is a different person than the tenant under the commercial lease being guaranteed;
  - The tenant's business was either a food, beverage or retail establishment or certain other business that was required to close to the public and was affected by COVID-19; and
  - The lease default triggering the guarantor's personal liability must occur between March 7, 2020 and September 30, 2020 (inclusive).

- It is unclear at this time if the language contained in the law that the personal liability (i.e guaranty) be contained "in a commercial lease or other rental agreement" includes stand-alone guaranties contained outside of the lease document.

- The new law also expands the prohibition on commercial tenant harassment to include a landlord's attempt to enforce a personal liability provision that the landlord knows, or reasonably should know, is not enforceable.

- The law is likely to be subject to judicial challenge on many levels, including challenges to its validity and challenges relating to ambiguities contained in the language of the law.

On May 26, 2020, Mayor de Blasio signed into law (Int. No. 1932-A/Local Law No. 2020/055) a bill that renders unenforceable personal liability of natural person guarantors under certain guaranties contained in certain commercial leases of real property located within New York City. This law became effective immediately. Specifically, the law renders unenforceable "a provision in a commercial lease or other rental agreement" for real property in New York City that provides for one or more natural persons, who are not the tenant under the lease, to be personally liable for the payment of rent, utility expenses, taxes or fees and charges relating to routine building maintenance, if both of the following conditions are satisfied:

(1) The tenant under the commercial lease being guaranteed satisfies any of the following relating to the various Executive Orders implemented by Governor Cuomo due to the COVID-19 pandemic:

   (a) Pursuant to Executive Order 202.3, the tenant was required to cease serving patrons food or beverage for on-premises consumption or to cease operation of its gym, fitness center or classes, movie theaters or video lottery or casino gaming; or

   (b) Pursuant to Executive Order 202.6, the tenant was a non-essential retail establishment subject to in-person limitations (i.e., the tenant was not an essential retail establishment like a grocery or convenience store, pharmacy, gas station, etc.); or

   (c) Pursuant to Executive Order 202.7, the tenant was a barbershop, hair salon, tattoo or piercing parlor or other provider of personal care services that was required to close to members of the public.

   and

(2) The default or other event causing such natural persons to become personally liable for such obligation occurred between March 7, 2020 and September 30, 2020, inclusive.

Furthermore, the law also expands the prohibition on commercial tenant harassment to include a landlord's attempt to enforce a personal liability provision that the landlord knows or reasonably should know is not enforceable pursuant to the foregoing. Landlords who engage in commercial tenant harassment may be subject to a civil penalty of $10,000–$50,000 (N.Y.C. Admin. Code § 22-903(a)).

Commentary

Int. No. 1932-A is aimed at protecting individuals who are guarantors of commercial leases to tenants operating food and beverage establishments and certain other non-essential businesses that were affected due to the COVID-19 pandemic. It is important to recognize that the law only addresses personal liability of "natural persons" and not guarantors that are entities. It is clear that by enacting this law, the New York City Council sought to benefit individuals rather than corporate entities.

It is widely believed that this law will be challenged on a myriad of constitutional grounds (including the contracts clause, *ultra vires* and the vagueness doctrine). In addition, there is drafting contained in the law that will likely engender challenges and the reliance upon interpretation from the courts, absent further legislative clarification from the New York City Council. One drafting issue is what is included as "retail establishment" and how broadly the New York City Council intended this concept to be interpreted. It is unclear if the New York City Council's intent was to merely include traditional "bricks and mortar" stores or to also include establishments providing all types of services on a "retail basis," which could arguably include certain types of office operations that render services on a retail basis.

Furthermore, it is important to recognize that the plain language of the law applies to personal liability provided in "[a] provision in a commercial lease or other rental agreement." In many instances, a guarantor's personal liability is contained in a stand-alone guaranty that is an agreement independent from the underlying "commercial lease or other rental agreement." It is unclear from the bill's legislative history whether the intent was for the law to apply to personal liability contained in such separate guaranty agreements. Although various stakeholders submitted comments that identified this issue, the New York City Council did not amend or clarify the definition of such "personal liability provision." Without further legislative guidance, this will likely be the basis upon which this law will be challenged in the courts.

The ambiguity as to whether this law applies to personal liability provisions in a separate guaranty may neutralize the threat of any civil penalty under the newly expanded harassment definition. Significantly, the New York City Council defined harassment to include "attempting to enforce a personal liability provision that the landlord

knows or reasonably should know is not enforceable pursuant to [the new law]." N.Y.C. Admin. Code § 22-902(a)(14) (emphasis added). If there is a legitimate doubt whether the new law applies to stand-alone guaranties, then it cannot be said that a landlord reasonably should have known the personal liability provision was not enforceable. Given the stakes at risk, it is likely that this issue and, as noted above, the validity of the law and other ambiguities will be subject to challenge and interpretation by the courts.

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