

New York City Enacts Law Affecting Enforceability of Certain Commercial Lease Guaranties for COVID-Affected Businesses

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On May 26, 2020, the Mayor of New York City, Bill de Blasio, signed a broad COVID-19 relief package into law, to supplement existing federal and state relief measures. The new legislation included several amendments to the Administrative Code of the City of New York (the “Code”) that affect commercial landlords and tenants, including N.Y.C. Council Int. No. 1932-A (“Local Law 1932-A”).

Criteria for Protection Under Local Law 1932-A

Local Law 1932-A protects individual guarantors of commercial leases from personal liability where the underlying tenant’s business was impacted by specific Executive Orders (“EOs”) issued by Governor Cuomo in connection with the COVID-19 pandemic. It provides that a “provision in a commercial lease or other rental agreement . . . that provides for one or more natural persons who are not the tenant under such agreement to become, upon the occurrence of a default or other event, wholly or partially personally liable for payment of rent . . . shall not be enforceable against such natural persons” if certain conditions are met with respect to (1) the guarantor, (2) the tenant, and (3) the default giving rise to personal liability.

(1) The Guarantor

To obtain the benefit of Local Law 1932-A, the guarantor in question must be: (i) a natural person (*i.e.*, not an LLC, partnership, corporation, or other business entity), and (ii) not the tenant under the lease agreement. Because of the typical circumstances in which natural persons provide personal guaranties of commercial leases, as a practical matter, this criteria generally limits Local Law 1932-A’s application to small businesses (where the individual principals thereof often provide a lease guaranty).

(2) The Tenant

For a guarantor to obtain the benefit of Local Law 1932-A, the underlying tenant must be one of the following types of businesses:

- A **restaurant or bar** that was required to cease serving patrons food or beverages for on-premises consumption pursuant to EO 202.3;
- A **gym, fitness center, movie theater, video lottery facility, or casino gaming facility**, that was required to cease operations under EO 202.3;
- A **non-essential retail establishment** subject to in-person limitations under guidance issued by the New York State Department of Economic Development pursuant to EO 202.6; or
- A **barbershop, hair salon, tattoo or piercing parlor, or related personal care service establishment** required to close to members of the public under EO 202.7.

These criteria limit Local Law 1932-A’s application to those businesses that were forced to stop or severely curtail their basic functions as a result of the pandemic. However, in contrast to certain relief afforded by other EOs, Local Law 1932-A does not require a demonstration of financial hardship as a result of the COVID-19 pandemic. Additionally, Local Law 1932-A does not apply to office tenants, including those that were subject to work-from-home requirements pursuant to the EOs.

(3) The Default

To obtain the benefit of Local Law 1932-A, the “default or other event causing such natural persons to become wholly or partially personally liable” must occur between March 7, 2020 and September 30, 2020. In this respect, Local Law 1932-A is retroactive and will apply to defaults that occurred prior to its enactment. Additionally, Local Law 1932-A will not merely defer until a later date a landlord’s ability to hold a guarantor personally liable for defaults that occurred during the March 7, 2020 to September 30, 2020 period, but rather will preclude a landlord from holding a guarantor personally liable for such defaults (assuming the above conditions are satisfied).

Local Law 1932-A also provides that attempting to enforce a personal liability provision that the landlord knows or should know is unenforceable pursuant to the above criteria is considered a form of “commercial tenant harassment” barred by the Code.

Impact of Local Law 1932-A

There are significant concerns and uncertainties within the commercial real estate industry about the impact and reach of Local Law 1932-A.

For instance, in at least one respect, the scope of Local Law 1932-A is unclear. The law states that it applies to “[a] provision in a commercial lease or other rental agreement” that provides for personal liability. However, many commercial lease guaranties – whether a full payment and performance guaranty, or a more limited guaranty (such as a Good Guy Guaranty) – are standalone documents that are separate from the lease, and thus arguably are not within the plain meaning of “[a] provision in a commercial lease or other rental agreement” However, excluding these forms of standalone guaranties would likely undermine the purpose of Local Law 1932-A, and elevate form over substance.

Additionally, Local Law 1932-A may significantly alter the default strategy, and negotiating leverage, for commercial landlords and tenants affected by Local Law 1932-A. Landlords that relied on the financial stability and creditworthiness of a guarantor at the time of lease execution may now face greater uncertainty with respect to their ability to pay lenders, building service providers, utility companies, insurance companies, taxing authorities and other landlord obligors in the event of a tenant’s default. In addition, depending on the circumstances, landlords may hesitate to agree to workouts or long-term renegotiations with tenants (such as lease modifications involving rent deferrals or abatements), because, given the underlying premise of Local Law 1932-A, landlords may be concerned that they will not ultimately have the right to seek recourse from a guarantor (even for defaults that occur after the period to which Local Law 1932-A initially applies). Thus, while Local Law 1932-A was intended to protect small businesses, it may have the unintended consequence of negatively impacting their workout/renegotiation prospects.

It should also be noted that Local Law 1932-A is limited to enforcement of personal guaranties, and does not affect the liability of the tenant on the underlying lease. As such, even after the enactment of Local Law 1932-A, a landlord may pursue other enforcement actions against the tenant (to the extent not curtailed by other EOs). However, as many tenant entities are special purpose vehicles, as a practical matter, a landlord’s ability to seek financial recourse against the tenant may be limited.

Finally, commentators have suggested that Local Law 1932-A will be challenged on constitutional grounds. The Contracts Clause of the U.S. Constitution prevents legislative interference with existing private contracts, and Local Law 1932-A effectively nullifies certain lease guaranties, albeit for a limited period. However, others have noted (including in testimony in support of the legislation), that New York case law allows private contracts to be

suspended by legislation enacted in response to a public emergency. See *Twentieth Century Associates v. Waldman*, 294 N.Y. 571, 582 (1945) (“The principle is firmly established today that all contracts are subject to the police power of the State, and, when emergency arises and the public welfare requires modification of private contractual obligations in the public interest, the question is not whether ‘legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end.’”). If this constitutional issue is raised, and how it is ultimately resolved, remains to be seen.