REAL PROPERTY

The Constitutionality of NYC's Law Affecting the Enforceability of Personal Guaranties for Commercial Leases

By Leslie Mendoza


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Due to the COVID-19 pandemic, many non-essential businesses have been forced to close. With many tenants demanding relief, the New York City Council adopted legislation, which would deem personal guaranties for commercial leases unenforceable for the period of March 7, 2020 to Sept. 30, 2020.

NYC Council's bill, Int. No. 1932-A, was signed by Mayor DeBlasio on May 26, 2020 and is effective immediately. The bill's purpose is to provide relief to NYC commercial tenants impacted by COVID-19. It temporarily prohibits the enforcement of personal liability provisions in commercial leases or rental agreements. The new law amends the Administrative Code of the City of New York by adding Section 22-1005 and adding Paragraph 14 to Subdivision a of Section 22-902 of the NYC Administrative Code.

The amendments to the NYC Administrative Code renders guarantee provisions unenforceable against natural persons who are not a tenant in commercial leases or other rental real property. The law would only impact liability for the payment of rent and other charges caused by an occurrence of default, and subject to the following conditions:

1. The tenant must satisfy at least one of the following:
   - The tenant was required to cease serving patrons food or beverage for on-premises consumption or to cease operation under EO 202.3;
   - The tenant was a non-essential retail establishment subject to in-person limitations under guidance issued by the NYS Department of Economic Development pursuant to EO 202.6; or
   - The tenant was required to close to members of the public under EO 202.7; and
2. The default or other event which caused the natural person to become personally liable for such obligation occurred between March 7, 2020 and Sept. 30, 2020, inclusive.

Under the new law, an attempt to enforce a personal liability provision that the landlord knows or reasonably should know is unenforceable, pursuant to the above, shall be deemed commercial tenant harassment, which could result in compensatory and punitive damages and attorneys' fees and court costs. See N.Y.C. Admin. Code § 22-903.

The language of the new law raises red flags and constitutional challenges are expected. Specifically, the challenge would be that it violates the Contracts Clause of the United States Constitution because it retroactively impairs personal guaranties entered into prior to the law's enactment. For such a claim to succeed, the initial inquiry, under the impairment of contracts clause, contains three components:

1. Whether there is a contractual relationship;
2. Whether a change in law impairs that contractual relationship; and
3. Whether the impairment is substantial. U.S.C.A. Const. Art. 1, § 10, cl. 1; *American Economy Ins. Co. v. State*.[1]

While tenants will surely argue that the bill does not substantially impair the parties' contractual relationship, as the bill only covers

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the party never identified in discovery (either through documents or in interrogatory responses) as a person with knowledge or information pertaining to the matter. In that scenario, the court might permit the non-moving party to take some discovery of that fact witness prior to summary judgment.

In this case, the court noted the lack of precedent regarding expert witness disclosure, and directed the parties to brief this issue. Thus, it allowed the defendant to show why it should be entitled to the specific expert discovery at that stage in the action. However, the defendant apparently did not capitalize on that opportunity. The defendant framed its motion not as one to compel limited disclosure of plaintiff's expert in connection with the summary judgment motion, but rather, to compel the plaintiff to comply with its previously made discovery demand for discovery relating to "every expert retained or employed by you…whom you expect to call *as a witness at trial*." (Emphasis in original). In essence, the defendant moved to compel the plaintiff to provide its CPLR 3101(d) expert disclosure in advance of the time period proscribed by statute, which had not yet expired. This was far broader than the discovery the defendant claimed to need in order to fully oppose summary judgment. In fact, the court found that the motion did not even address that seemingly critical issue. The defendant also sought to preclude the plaintiff (pursuant to CPLR 3126) from offering any expert testimony on summary judgment. The court rejected that argument because CPLR 3212(b) expressly directs a court not to reject an expert affidavit simply because there had not yet been disclosure of the expert in accordance with CPLR 3101(d).

Why the defendant structured its motion to compel in that way is unknown. Perhaps it was hoping for more discovery than the court had initially considered permitting at that juncture. Whatever the reason, the defendant did not address the court's concern. We are left without any guidance on whether a party may obtain expert disclosure outside of the normal course of CPLR 3101(d) solely to respond to a motion for summary judgment.

Note: Hillary A. Frommer is counsel in Farrell Fritz's Estate Litigation Department. She focuses her practice in litigation, primarily estate matters including contested probate proceedings and contested accounting proceedings. She has extensive trial and appellate experience in both federal and state courts. Ms. Frommer also represents large and small businesses, financial institutions and individuals in complex business disputes, including shareholder and partnership disputes, employment disputes and other commercial matters.

1. 2020 NY Slip Op 50449(U) (Sup Ct, NY County April 14, 2020).

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rent and payments for the period of March 7, 2020 to Sept. 30, 2020 and that it is necessary to address the effects of the coronavirus pandemic, landlords will counter that the personal guarantee was a material term of the lease and a substantial reason that the landlord agreed to enter into the contract, which is common practice in commercial leases in New York City.

The U.S. Supreme Court has held that an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose because "limited and temporary interpositions with respect to the enforcement of contracts [may be allowed] if made necessary by a great public calamity."[2] The current coronavirus pandemic has surely made unprecedented changes and it can be argued that the NYC Council's bill is a reasonable and necessary solution to the issues that current commercial personal guarantors as businesses were forced to close.

On the other hand, the Court of Appeals has previously struck down similar government interference in contracts. In *Patterson v. Carey*[3], the Court of Appeals struck down Public Authorities Law, ss 153-a, 153-b, subd. 5., which curtailed toll authority bondholders' ability to increase their tolls for Jones Beach State Parkway on constitutional grounds. Prior to the law, an essential attribute of the authority's contract with the state, which granted the authority power to increase the toll and agreed that the state not limit or alter rights vested in the authority. With the law in place, the Legislature diminished bondholders' rights and deprived them of a right granted by their contract with the authority and the state. Thus, the court held that the law violated the contract clause of the U.S. Constitution.

The new law would likely undergo similar challenges as the law in *Patterson* and it would likely be deemed unconstitutional. Its impairment to contractual rights agreed upon by landlords and guarantors would be substantial, especially considering that the bill does not merely delay a landlord's right to enforce the guarantee during the period stated, it extinguishes it altogether. Further, it runs afoul of well-established precedent enforcing arm's length agreements between sophisticated and counseled parties.[4]

The question remains, is the new law constitutional? From the tenants' perspective, it would surely address issues caused by the Covid-19 pandemic and thus, reasonable and necessary. From the landlords' perspective, it creates added risk to a negotiated agreement which the landlord entered into in reliance of the personal guaranty, which may be deemed substantial enough to render the law unconstitutional.

Note: Leslie Mendoza is an associate at Lieb at Law, P.C. She focuses her practice on real estate litigation and compliance. She can be reached at Leslie.Mendoza@liebatlaw.com.

1. 30 N.Y.3d 136 (2017)
2. *Home Bldg. & Loan Assn. v. Blaisdell*, 54 S.Ct. 231, 240.
3. 41 N.Y.2d 714 (1977).
4. *159 MP Corp. v. Redbridge Bedford, LLC*, 33 N.Y.3d 353 (2019); *Vermont Teddy Bear Co., Inc. v. 538 Madision Realty Co.*, 775 N.Y.S.2d 765 (2004).