New NYC Law Prohibits Enforcement Of Some Lease Guaranties

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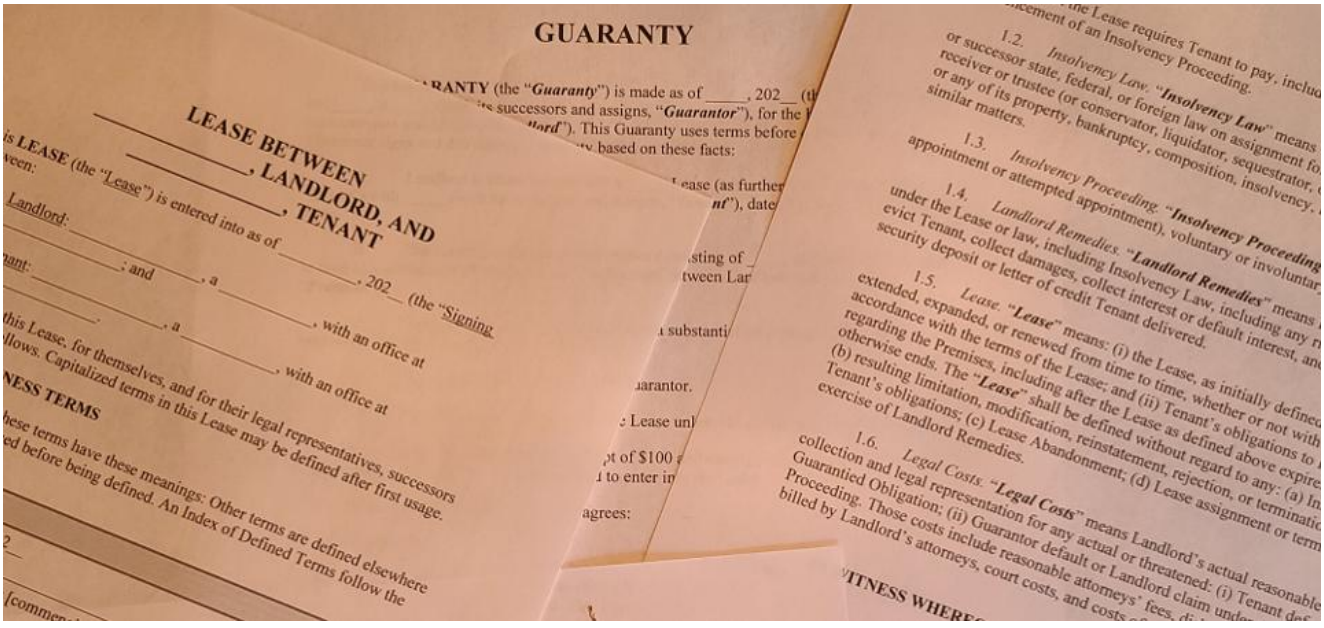
New York City doesn't think property owners should enforce the personal guaranties that often backstop commercial leases signed by small business corporations or limited liability companies. So on May 26 the city enacted a law against it, at least in cases where the tenant's business had to shut down because of today's pandemic. The law applies through September 2020.

The words of the city's new law on personal guaranties sound very serious and broad. But they likely do not achieve the city's goal.

First, the legislation blocks enforcement of any personal guaranty provision "in a commercial lease or other rental agreement." But personal guaranty provisions don't appear "in" leases or "in" rental agreements. Instead, guaranty provisions appear in separate contracts called guaranties. A guaranty is not a "rental agreement." Maybe this sounds like a technicality. Maybe courts will interpret "rental agreement" to mean any agreement at all, related to or entered into in connection with a lease. But that's a stretch.



NYC property owners just lost their right to enforce guaranties of some commercial leases.
Joshua Stein

A guaranty does not involve "rental" of anything. Its sole function is to backstop a tenant's obligation to pay money. The tenant isn't a party to the guaranty. The guarantor doesn't rent anything. The guaranty provisions simply are not "in" the lease or any rental

agreement. Typically, the owner would never have signed the lease without that separate contract with the guarantor. An owner needs a predictable income stream to match the owner's all-too-predictable expenses. About a third of those expenses are typically property taxes due the city, with an 18% interest rate if paid late. Another 5% or 10% of the expenses are city water and sewer charges. And that's just the beginning. Any owner needs rent to pay its expenses.

If the city meant to invalidate separate guaranty contracts, it should have mentioned "guaranties." And the new law entirely misses the fact that many, probably most, small business leases are signed directly with an individual tenant, a living and breathing person, so no guaranty plays any role at all. The individual tenant just has to pay the rent.

Second, the legislation invalidates any provision by which someone other than the tenant will "become" liable for certain payments "upon the occurrence of a default or other event." Usually lease guaranties don't say the guarantor will "become" liable in the future. Instead, the guarantor assumes full liability for the tenant's payments from the beginning. So, even if the legislation applies to guaranties at all, it still doesn't actually apply to most guaranties because they usually don't say a guarantor will "become" liable at some future date.

In New York, however, the verb "become" has a unique meaning not found in ordinary English dictionaries: if a building, for example, is already subject to a particular law, it can still "become" subject to that very same law because of later events. So in New York the verb "become" also means "continue to be."[1] Based on that very special state-specific meaning of the verb "become," a court might reject the argument in the previous paragraph.

Third, the new law invalidates any provision that makes someone personally obligated to pay "rent, utility expenses or taxes . . . or fees or charges relating to routine building maintenance." That sounds like an impressive and broad list, but most leases require payment of many items not on that list, including particularly legal fees and damages if the owner prematurely terminates the lease for default. So even if the legislation applies to guaranties, an owner could still enforce significant obligations of the guarantor. And nothing in the law excuses the owner from any of its very significant obligations to the city, building staff, and other creditors.

Finally, the new law ignores how a commercial lease actually works. Assume a tenant stops paying before September 30. The owner can apply the security deposit to pay rent. That eliminates the tenant's default. On October 1, the owner can require the tenant to replenish the deposit. If the tenant doesn't comply, that default now occurs after September 30. On October 1, the tenant may owe piles of money and want to stay in business, but the owner can, on October 2, seek to terminate the lease and recover damages from both tenant and guarantor. The new law does not prohibit any of this.

In short, the new law might have benefitted from more thought on how the real world of leases and guaranties actually works. The city might also consider the United States Constitution, which prohibits any "Law impairing the Obligation of Contracts." (Article I, Section 10, Paragraph 1.) The courts sometimes disregard that prohibition if a legislature can come up with some legitimate-sounding reason to override a contract. Other times, the courts apply the Constitution as written.

(Thanks to Michelle Maratto Itkowitz, for suggesting this article.)

[1] Roberts v Tishman Speyer Props., L.P., 13 N.Y.3d 270 (2009) ("[T]here is nothing impossible, or even strained, about reading the verb 'become' to refer to achieving, for a second time, a status already attained."). See also L. Carroll, Through the Looking Glass ("When I use a word, … it means just what I choose it to mean—neither more nor less," quoting Humpty Dumpty).

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