

NEW YORK COURT OF APPEALS ROUNDUP

FREEDOM TO CONTRACT, PUBLIC POLICY AND ‘YELLOWSTONE’

WILLIAM T. RUSSELL, JR. AND LYNN K. NEUNER*

SIMPSON THACHER & BARTLETT LLP

June 18, 2018

The Court of Appeals issued a significant real estate decision showcasing a debate on the freedom to contract and the circumstances under which parties’ negotiated contract terms will be disregarded based on public policy grounds. In *159 MP Corp., et al., v. Redbridge Bedford, LLC*, the court issued a 4-3 split decision enforcing a contractual provision waiving a commercial tenant’s right to bring a declaratory judgment regarding the lease terms. The waiver of the declaratory judgment suit also operates as a waiver of the right to seek a “Yellowstone injunction,” which tolls the cure period for an alleged breach of a lease until the declaratory judgment is issued, allowing the tenant to occupy the rented space while the parties’ rights are being determined and, if the tenant loses on the merits, an opportunity to cure the defect. The majority, in a decision authored by Chief Judge DiFiore and joined by Judges Stein, Garcia and Feinman, held that the lease contract should be enforced as written and the waiver should be given full effect. The dissent, authored by Judge Wilson and joined by Judges Rivera and Fahey, argued that the public policy favoring declaratory judgments should trump the policy favoring freedom of contract.

The case concerns leases for a large grocery store, Foodtown, occupying 13,000 square feet in the Williamsburg section of Brooklyn. The tenants, 159 MP Corp. and 240 Bedford Ave Realty Holding Corp. (collectively, “MP”), signed leases in 2010, each with a 20-year period with an option to renew for another 10 years after that. The leases were originally signed with BFN Realty Associates LLC, which sold the building to defendant Redbridge Bedford, LLC in 2012. In 2014, Redbridge sent MP notices of default with 15 days to cure. The default notices stated that the tenant had built out the premises without obtaining proper permits; that the configuration of the store violated egress requirements under the lease and posed a fire hazard; that the tenant had illegally combined premises in configuring the store; that the ventilation system violated the lease and was a nuisance; and that the tenant failed to provide the fire department with inspection access to the sprinkler system.

MP filed suit the day before the cure period ended, seeking a declaratory judgment, suing for breach of contract and equitable estoppel, and moving for a Yellowstone injunction. MP claimed that it had the necessary building permits, that the prior building owner had acquiesced to the store configuration, and that Redbridge was required to alter the building and obtain a new certificate of occupancy, thus preventing any “cure” activities in the meantime. Redbridge moved for summary judgment dismissing the complaint based on the following contractual waiver:

* **William T. Russell, Jr. and Lynn K. Neuner** are partners at *Simpson Thacher & Bartlett LLP*.

Tenant waives the right to bring a declaratory judgment action with respect to any provision of this Lease or with respect to any notice sent pursuant to the provisions of this Lease. Any breach of this paragraph shall constitute a breach of substantial obligations of the tenancy, and shall be grounds for the immediate termination of this Lease. It is further agreed that in the event injunctive relief is sought by Tenant and such relief shall be denied, the Owner shall be entitled to recover the costs of opposing such an application, or action, including its attorney's fees actually incurred, it is the intention of the parties hereto that their disputes be adjudicated via summary proceedings.

The Supreme Court found in favor of the landlord and dismissed the case, holding that it was clear that MP waived the right to bring a declaratory judgment action, which implicitly waived any entitlement to a Yellowstone injunction. The Appellate Division, Second Department affirmed (with a dissent), finding that the "right to a declaratory judgment, inclusive of the Yellowstone relief sought here, is not so vaulted as to be incapable of self-alienation."

On appeal, the majority extolled the importance of providing contracting parties with predictability and certainty. The court noted that the litigants are sophisticated commercial entities that had counsel and made handwritten edits to numerous provisions of the lease, including the rider containing the waiver provision. The court observed that the tenants were not arguing duress, coercion or unconscionability. Rather, the tenants argued the waiver provision should be set aside on the grounds that the right to bring a declaratory judgment is so critical to New York's public policy that it cannot be waived. The court rejected this position, holding that "[o]nly a limited group of public policy interests has been identified as sufficiently fundamental to outweigh the public policy favoring freedom of contract," and that the right to file a declaratory judgment suit did not rise to this level.

Indeed, the court noted other instances where it had enforced the waiver of a declaratory judgment action. In *Kalisch-Jarcho, Inc. v. City of New York*, the court held that a construction contractor was barred from bringing a declaratory judgment action where it had contractually agreed to use an administrative procedure to resolve mid-project disputes. 72 N.Y.2d 727 (1988). Moreover, the court regularly enforces mandatory arbitration clauses, which prohibit access to courts for the initial adjudication of disputes altogether.

The court observed that the waiver provision at issue does not preclude access to the courts as it specifically provided for adjudication of disputes in a summary proceeding, which would go forward pursuant to Real Property Actions and Proceedings Law article 7, a mechanism designed for expeditious and fair resolution of landlord-tenant disputes. In context, the court found that declaratory judgments are "merely one tool for litigating a dispute," that the tenants could still raise defenses in summary proceedings and vindicate their lease rights, and that their inability to obtain a Yellowstone injunction did not transform the declaratory judgment option into an inalienable right. The court reasoned that a tenant may want the capacity to give a waiver in exchange for other valuable rights, such as rent concessions or cure periods, and that the court must respect and enforce the terms of the parties' negotiated bargain.

The dissent focused on the historical origins of the declaratory judgment suit and the pivotal role it plays in allowing parties to determine their respective rights and obligations prior to engaging in activity that could be deemed a breach. Judge Wilson traced the origins of the declaratory judgment procedure from Roman times through the Middle Ages and into the early 20th Century, where New York played an early role in adopting the declaratory judgment device as a prudential method for settling parties' disputes. The dissent also focused on the freedom to contract as a societal good as opposed to an individual right and argued that the majority opinion prizes the parties' individual decision to negotiate away rights over the societal benefit of having parties resolve landlord-tenant disputes in a less disruptive fashion by allowing tenants to remain on premise

while disputes are adjudicated and to retain the ability to cure defects following adjudication of the merits. Ultimately, the dissent finds that the right to bring a declaratory judgment suit is the method “[t]hat best preserves the substance of their bargain and provides assurance to future negotiating parties that our law will not require a Hobson’s choice of them.” In the dissent’s view, a party should therefore not be allowed to give up the right, for the benefit of society.

The dueling opinions of the Court of Appeals present diverging approaches to the enforcement of the plain terms of the contract. Both the majority and the dissent agree that the undisputed words, bargained for by the parties, provide for a waiver of the tenant’s right to bring a declaratory judgment suit. The dissent proffers that the “best” or most efficient dispute resolution method involves a declaratory judgment with an attendant Yellowstone “preserve the status quo” injunction, and that this policy should take precedence over the parties’ agreement. The majority prioritizes the predictability of enforcing the written and bargained-for word and stressed the importance of this predictability in maintaining New York’s position as a leading financial center. The majority accordingly notes that “[i]n keeping with New York’s status as the preeminent commercial center in the United States, if not the world, our courts have long deemed the enforcement of commercial contracts according to the terms adopted by the parties to be a pillar of the common law.”

This article is reprinted with permission from the June 18, 2019 issue of New York Law Journal. © 2018 ALM Media Properties, LLC. Further duplication without permission is prohibited. All rights reserved.