



CHAPTER

26

A large, blue-tinted photograph of a modern glass skyscraper. The building has a complex, multi-level structure with many windows. A white frame is superimposed over the image, enclosing the central text. The overall color scheme is blue and white.

GUARANTY

CHAPTER 26

Guaranty

PLUG COSTLY LOOPHOLES IN YOUR TENANTS' LEASE GUARANTIES

You probably refuse to rent space to any new and unproven tenant or to a shell company unless its lease is backed by a guaranty. A lease guaranty assures you that if the tenant defaults—that is, fails to uphold its lease obligations—a third party, known as the guarantor, will perform the tenant's lease obligations. But your lease guaranty may give you less protection than you think, especially if you rely on standard-form, boilerplate guaranties. Those forms may fail to cover key points or may have other loopholes that could easily let the guarantor off the hook.

To help ensure that the lease guaranty fully protects you, with the help of New Jersey attorney Marc L. Ripp and New York City attorney Robert P. Reichman, here are 18 points that will help you draft an acceptable guaranty, and some Model Language that you can adapt and use in your guaranty.

Loopholes Let Guarantor Skirt Obligations

Certain loopholes can limit or eliminate entirely the guarantor's obligations unless the guaranty explicitly closes those loopholes, say Reichman and Ripp. For example:

Lease is modified. In general, the law says that if a lease is modified, the guarantor of the original lease is relieved of liability unless he agrees to be bound by the modified lease. Why? The guarantor promised to guaranty the lease as written, not the lease as modified.

Tenant fails to repair. Some guaranties are "guaranties of payment" only. They require the guarantor to reimburse you if the tenant doesn't pay rent. But that's all they require the guarantor to do. If the tenant defaults in some other way (for example, fails to make required repairs), you can't hold the guarantor liable for the tenant's default.

Guarantor goes broke. A guaranty is designed to protect you if the tenant goes broke, but what if the guarantor goes broke, too? The guarantor may be protected by the bankruptcy laws and may be allowed to avoid certain debts—like yours. So you may be unable to collect from either the bankrupt tenant or its bankrupt guarantor. This is a particular danger when, as often happens, the tenant and the guarantor are related—say, the guarantor is an officer of the tenant corporation or the parent corporation.

18 Key Points When Drafting Your Guaranty

To ensure that your guaranty keeps a guarantor on the hook, use our 18 points when drafting a guaranty. The Model Language may be inserted into a new or an existing guaranty.

Require 'Guaranty of Performance'

Your guaranty should be a "guaranty of payment and performance," not just a guaranty of payment, advises Reichman. A guaranty of payment requires the guarantor to pay only if the tenant defaults on

the rent, additional rent, or any other payment due under the lease. But with a broader guaranty of payment and performance, the guarantor guaranties all of the tenant's lease obligations, both monetary and nonmonetary. So not only would the guarantor be liable for the tenant's nonpayment of rent, but if the tenant made unauthorized alterations or moved out of its space and left behind property, the guarantor would be liable for the cost of restoring or cleaning up the space.

Model Language

Guarantor hereby unconditionally and irrevocably guaranties to Landlord:

- a. The due and punctual payment in full (and not merely the collectibility) of all Rent, Additional Rent, and all other amounts due and payable by Tenant under the Lease; and
- b. The full and faithful performance and observance of all terms, covenants, and conditions contained in the Lease to be performed or observed by Tenant.

Make Guarantor Liable After Waivers, Modifications, Extensions, and Transfers

There are many situations that may inadvertently result in the guarantor's being released from its guaranty obligations, such as:

- The tenant violates the lease, but you don't take any action against it. In other words, you waive your right to force the tenant to comply with the lease;
- You act as if the guaranty wasn't in effect—for example, you sue the tenant if it doesn't pay its rent, without asking the guarantor for payment;
- You and the tenant modify or amend the lease for any reason without getting the guarantor's okay;
- You and the tenant renew or extend the lease without the guarantor's agreement to remain on the hook; and
- You assign or transfer your building or center to a third party or consent to the tenant subletting or assigning its lease.

Require the guarantor to agree to remain on the hook in each of the above situations, says Reichman. And make it clear in the guaranty that the guarantor isn't entitled to receive notice that any of those events will occur.

Model Language

Guarantor expressly agrees that Landlord may, in its sole and absolute discretion, without notice to or further consent of Guarantor and without in any way releasing, affecting, or impairing the obligations and liabilities of Guarantor hereunder:

- a. Waive compliance with any of the terms of the Lease;
- b. Modify, amend, or change any provisions of the Lease by agreement between Tenant and Landlord;
- c. Grant extensions or renewals of the Lease and/or effect any release, compromise, or settlement in connection therewith;
- d. Assign or otherwise transfer all or part of its interest in the Lease, Premises, or this Guaranty or any interest therein or herein; and
- e. Consent to an assignment, subletting, conveyance, or other transfer of all or any part of the interest of Tenant in the Lease.

Keep Guarantor on Hook if Tenant Holds Over

Make it clear that the guarantor will remain on the hook if the tenant holds over—that is, stays in its space—after the lease ends, says Ripp.

Model Language

If Tenant holds over beyond the term of the Lease, Guarantor's obligations hereunder shall extend and apply with respect to the full and faithful performance and observance of all of the covenants, terms, and conditions of the Lease and of any such modification thereof.

Keep Guarantor's Estate Obligated if Guarantor Dies

If the guarantor is an individual, the guaranty shouldn't terminate upon his death, says Ripp. You should be entitled to collect from the guarantor's estate if the tenant defaults.

Model Language

This Guaranty, and all of the terms hereof, shall be binding on Guarantor and the successors, assigns, and legal representatives of Guarantor.

Keep Guarantor's Spouse Obligated Under Guaranty

This is a key consideration in states (for example, California) where the law says that marital property is "community property"—if the guarantor is an individual. In these states, Ripp says, the guarantor's spouse should sign the guaranty agreement, too.

Otherwise, you may not be able to recover the guarantor's assets that qualify as community property.

Don't Agree to Send Default Notices to Guarantor

You should not be required to send default notices to the guarantor before the guarantor must perform his obligations, says Ripp. Notifying the guarantor is burdensome, repetitious, and wastes your time—after all, you must already notify the defaulting tenant.

Model Language

Guarantor does not require and hereby waives all notices of Tenant's nonpayment, nonperformance, or nonobservance of the covenants, terms, and conditions of the Lease. Guarantor hereby expressly waives all notices and demands otherwise required by law which Guarantor may lawfully waive.

Get Right to Immediately Collect Late Rent from Guarantor

You should be able to demand that the guarantor pay the rent or other money as soon as the tenant misses a payment. But you can't if you have only a "guaranty of collection." In that case, you must sue the tenant, win, and unsuccessfully try to collect from it before you can go after the guarantor. This whole process could take a long time, says Ripp. Make sure that the guaranty says you don't have to go through this lengthy process.

Model Language

Insofar as the payment by Tenant of any sums of money to Landlord is involved, this Guaranty is a guaranty of payment and not of collection, and shall remain in full force and effect until payment in full to Landlord of all sums payable under the Lease. Guarantor waives any right to require that Landlord bring any legal action against Tenant before, simultaneously with, or after enforcing its rights and remedies hereunder against Guarantor.

Don't Be Required to Exhaust Other Remedies Before Collecting from Guarantor

Avoid having to deplete the security deposit or exhaust any other remedies against the tenant before going after the guarantor, says Reichman. Ripp has seen cases where a guarantor would insist that the owner use up the tenant's security deposit before suing the guarantor if the guaranty didn't address that issue. To avoid this situation, Reichman recommends the following language:

Model Language

Landlord shall not be required to make any demand on Tenant, apply any security deposit being held by Landlord on behalf of Tenant or any other credit in favor of Tenant, or otherwise pursue or exhaust its remedies against Tenant before, simultaneously with, or after enforcing its rights and remedies hereunder against Guarantor.

Don't Release Guarantor if Tenant's Net Worth Increases

Some guarantors argue that they're needed only as long as the tenant is a poor credit risk. They try to include a provision saying that if the tenant's net worth reaches a certain dollar amount, the guaranty ends. Try to avoid including a clause like this in the guaranty, warns Ripp. The lease should be guaranteed under all conditions; even a financially healthy tenant may have sudden financial reverses, he notes.

Keep Guarantor on Hook if Tenant Goes Bankrupt

A guarantor usually stays accountable if the tenant goes bankrupt—regardless of whether the tenant or its bankruptcy trustee either rejects or assumes and assigns the lease. But it's best to add language to the guaranty that clearly states that the guarantor remain on the hook, says Reichman. This helps to avoid any confusion in the future, he explains.

Model Language

Neither Guarantor's obligation to make payment in accordance with the terms of this Guaranty nor any remedy for the enforcement thereof shall be impaired, modified, released, limited, or affected in any way by any impairment, modification, release, or limitation of the liability of Tenant or its estate in bankruptcy, resulting from:

- a. The operation of any present or future provision of the Bankruptcy Code of the United States or from the decision of any court interpreting the same;
- b. The rejection, or disaffirmance, of the Lease in any such proceedings; or
- c. The assumption and assignment or transfer of the Lease by Tenant or Tenant's bankruptcy trustee.

Require Information to Monitor Guarantor's Ongoing Creditworthiness

You won't be properly protected from a tenant's default if the guarantor's net worth has plummeted. So the lease must require the tenant to give you extra

security in that situation, says Ripp. For instance, you could require the tenant to get a guaranty from a more creditworthy guarantor. Or you could get another form of security: a cash security deposit or a letter of credit, says Ripp.

To keep an eye on the guarantor's creditworthiness, you'll want to have the right to monitor his financial condition, says Reichman. So require the guarantor to give you an annual or quarterly financial statement.

Model Language

Every year throughout the Lease term, on the first day of each January, Guarantor shall deliver to Landlord the following information regarding Guarantor's creditworthiness:

- a. Current, complete, accurate, and detailed audited financial statements of Guarantor;
- b. Current bank references for Guarantor; and
- c. A Dun & Bradstreet report on Guarantor, if available.

- ◆ **PRACTICAL POINTER:** You will also want a right in the lease to get more security from the tenant if a guarantor violates his guaranty or dies, says Ripp.

Require Authorization by Proper Corporate Procedures

Corporate guarantors sometimes try to avoid their debts by arguing that the corporation didn't officially agree to be obligated under the guaranty. Or the guarantor might argue that the officer who signed the guaranty didn't have the power to sign for the corporation, says Ripp. To protect yourself, make the guarantor promise that the guaranty has been properly authorized by the corporation, signed by an authorized officer, and will bind the guarantor.

Model Language

Guarantor represents and warrants that this Guaranty has been duly authorized by all necessary corporate action on Guarantor's part, has been duly executed and delivered by a duly authorized officer, and constitutes Guarantor's valid and legally binding agreement in accordance with its terms.

In very large transactions, Reichman suggests that you request an "opinion letter" from the guarantor's attorneys that certifies the enforceability and proper authorization of the guaranty.

Make Tenant and Guarantor 'Jointly and Severally' Liable

Give yourself flexibility to sue the guarantor alone, the tenant alone, or both of them at once. Have the guaranty say that both the guarantor and the tenant are "jointly and severally" liable, says Ripp.

Model Language

The liability of Guarantor is coextensive with that of Tenant and also joint and several, and legal action may be brought against Guarantor and carried to final judgment either with or without making Tenant a party thereto.

Make Guarantor Agree Not to Sue Tenant Until Default Is Cured

The guaranty should say that if the tenant defaults, the guarantor may not sue the tenant until after the guarantor cures the default, says Reichman. The guarantor may want to sue the tenant before it fulfills the tenant's lease obligations. But you'll want the guarantor to first fulfill those lease obligations. Otherwise, you may have to wait until the guarantor's lawsuit ends, which could be a long time, says Ripp. And, he adds, require the guarantor to agree to subordinate any claims it has against the tenant to yours—that is, place its claims behind yours in the line to get paid.

Model Language

Until all of Tenant's obligations under the Lease are fully performed, Guarantor:

- a. Waives any rights that Guarantor may have against Tenant by reason of any one or more payments or acts in compliance with the obligations of Guarantor under this Guaranty; and
- b. Subordinates any liability or indebtedness of Tenant held by Guarantor to the obligations of Tenant to Landlord under its Lease.

Get Waiver of Applicable Statute of Limitations

Every state's laws include statutes of limitations, saying that after a specified time period, certain kinds of lawsuits may no longer be started. For example, in New Jersey, you can't sue for a lease default more than six years after the default, says Ripp. It's to your advantage to have the guarantor waive the statute of limitations so that you won't be limited to a specified time period to sue the guarantor. But check your state laws. While many states will let a guarantor waive the statute of limitations in the guaranty, others won't, Ripp says. If your

state lets a guarantor waive the statute of limitations, add this language to the guaranty:

Model Language

Guarantor waives the benefit of any statute of limitations affecting Guarantor's liability under this Guaranty.

Get Right to Enforce Guaranty Under Your State's Laws, in Desired Locale

Some states' laws are more favorable to enforcing guaranties than others. So ask your attorney to decide which state's law should govern the guaranty—usually the state where the tenant's space is located, says Reichman. And since the guarantor might be located far from your center, building, or office, you should require the guarantor to agree to come to the court that you choose, he adds. Otherwise, if there's a lawsuit, the guarantor may insist that it be tried in his state or on the other side of your state—which might be inconvenient and expensive for you. Also, if the guarantor is a foreign or out-of-state entity, make sure it picks an in-state agent (typically, a local attorney) to accept legal documents—such as papers to start a lawsuit—on the guarantor's behalf, says Reichman.

Model Language

This Guaranty shall be governed by and construed in accordance with the laws of the State of *[insert name of state]* applicable to agreements made and to be wholly performed within the State of *[insert name of same state]*. Guarantor hereby consents to the jurisdiction of any competent court within *[insert county and state where space is located, e.g., County of Westchester, State of New York]* and *[insert county and state where your office is located, e.g., County of New York, State of New York]* in Landlord's discretion, including, without limitation, Federal courts of the United States, and hereby appoints *[insert name of agent]* as its agent to receive service of process for other legal summons by any means authorized by the State of *[insert name of state]*.

Require Guarantor to Waive Jury Trial

If it becomes necessary to sue the guarantor, a jury trial is more expensive, takes much longer to reach a result, and legal fees are higher. Plus juries may

tend to view owners in a bad light, so they may deliver a verdict against you. So demand a trial without a jury, says Reichman.

Model Language

Guarantor hereby waives trial by jury in any action brought on or with respect to this Guaranty.

Require Guarantor to Pay Your Legal Fees for Enforcing Guaranty

If you can avoid paying for a lawsuit against the guarantor, so much the better. Make the guarantor pay your legal fees if you must sue to enforce the guaranty, says Reichman.

Model Language

Guarantor agrees to pay all costs and expenses incurred by Landlord in enforcing this Guaranty, including, without limitation, all legal fees and disbursements.

Use Affidavit as Evidence of Tenant's Personal Guaranty Default

A tenant signed a five-year lease for office building space and, at the same time, signed a personal guaranty, guaranteeing his rent obligations under the lease. The tenant moved out of the office space one year before the lease term was to end, but the owner didn't relet the office to a new tenant. Instead, it sued the tenant for all of the outstanding base rent and additional rent—totaling \$42,571.84—that the tenant owed under the lease and had personally guaranteed. The owner asked the court for a judgment in its favor without a trial, and it was granted.

The court pointed out that, to enforce a written personal guaranty, all that the creditor needed to prove was the existence of an "absolute and unconditional" guaranty, the amount of the underlying debt, and the tenant's failure to perform under the guaranty. The owner proved this by submitting a copy of the lease, a copy of the guaranty, an arrears statement with an accounting of overdue payments, and an affidavit from its managing agent stating the tenant failed to pay his rent. The court determined that the guaranty and affidavit produced by the owner demonstrated it was entitled to the rent and additional rent payments it sought [347 West 36th Street LLC v. Dibenedetto, August 2010].

SAFEGUARDS TO AVOID GETTING BURNED BY GUARANTY WITH DECREASING DOLLAR CAP

Tenants and their guarantors often demand that a decreasing “dollar cap” be put on a guaranty. This limits the guarantor’s liability to a set dollar amount, and then the cap decreases—or “burns off”—over the lease term. While agreeing to a decreasing dollar cap can close your deal, you could lose more than you bargained for if you’re not careful. For instance, if the dollar cap starts out too low or the cap burns off too quickly, and the tenant goes bust early in the lease term, you might not get enough money from the guarantor to cover even your out-of-pocket costs.

To help you avoid that situation, with the help of New York City attorney Robert P. Reichman, New Jersey attorney Marc L. Ripp, and Denver attorney Mark A. Senn, we will give you five safeguards to use if you must agree to a guaranty with a decreasing dollar cap.

How Decreasing Dollar Cap Works

Before you can set up a decreasing dollar cap in a guaranty, Ripp notes that you, the tenant, and the guarantor will need to negotiate these four points:

- The initial amount of the dollar cap;
- The length and timing of the burn-off period;
- The date(s) each decrease will take effect (these dates often fall on the anniversary of a key lease date, such as the lease’s commencement date); and
- The amount of each decrease.

There are many possibilities for when and how much the dollar cap will decrease. For example, if the tenant signs a 15-year lease, you might agree on a burn-off period over the first 10 years of the lease term, with the dollar cap decreasing by .10 multiplied by the original amount of the dollar cap per year. Or you might agree that the dollar cap will decrease twice during the 10-year period: by one-half in the fifth year of the lease term and then eliminated entirely in the 10th year.

The outcome of your negotiations on those four points will depend on several factors, such as the tenant’s net worth, the kind of business it operates, its track record, its future prospects, the size of its security deposit, and each party’s bargaining

power, says Reichman. Be aware that if the tenant has lots of negotiating power, you may be forced to accept a rapidly decreasing dollar cap over a short period of time.

Five Decreasing Dollar Cap Safeguards

If you’re compelled to accept a decreasing dollar cap on the guarantor’s liability, then include these five safeguards in the guaranty:

Safeguard #1: Start cap high enough to cover up-front lease costs. Start the dollar cap at a level high enough to cover at least your out-of-pocket lease costs, says Reichman [Clause, par. a]. Although this may be a fraction of the total rent the tenant owes, it will cover your downside if the tenant commits a violation early in the lease. These out-of-pocket costs include: broker’s commissions, buildout costs and/or tenant improvement allowances, takeover costs (if you must buy out the tenant’s existing lease to get it into your building or center), and rent concessions (e.g., free rent).

Safeguard #2: Exclude certain costs from cap. Make sure that the dollar cap doesn’t apply to certain costs, notes Reichman. For instance, don’t cap your collection costs or attorney’s fees. Otherwise, you’ll lose money for enforcing the lease or guaranty. And don’t cap the amount the guarantor owes you for the tenant’s environmental contamination at the space, says Senn, because environmental claims against you could be very large.

Also, don’t let the guarantor cap the amount it owes for losses you suffer because the tenant’s conduct is negligent or intentional—for example, if the tenant intentionally sets fire to its space, says Ripp [Clause, par. a]. But Senn doesn’t believe that a guarantor should be liable for those losses.

Safeguard #3: Avoid cap tied to rent payment. Once you’ve agreed to the initial amount of the dollar cap, be careful of the wording you use in the guaranty, warns Senn. A sneaky guarantor might try to initially cap its obligations by saying it guaranties only the “payment of \$100,000 of rent” under the lease. That may mean that once the tenant pays \$100,000 of rent, the guaranty terminates. You can’t go after the guarantor if the tenant then stops paying rent. To avoid that outcome, require the guaranty to say that

Model Guaranty Clause: Guaranty Cap Decreases Only if Certain Conditions Are Met

The following Model Guaranty Clause was drafted by New York City attorney Robert P. Reichman, New Jersey attorney Marc L. Ripp, and Denver attorney Mark A. Senn. Use it if your tenant demands that you cap its guarantor's liability and then decrease the amount of the cap over time. Show this clause to your attorney before requiring the tenant to put it into the guaranty.

DECREASING DOLLAR CAP

- a. Dollar Cap.** Guarantor's total monetary liability under this Guaranty will not exceed \$[insert amt.] ("Dollar Cap"), exclusive of Landlord's costs of collection and attorney's fees, and all of Landlord's costs, liabilities, fines, damages, penalties, judgments, and losses arising from:
- (i) Tenant's default under Clause [insert # of clause discussing tenant's environmental duties and liabilities] of this Lease; or
 - (ii) Tenant's negligent or willful misconduct.
- b. Decrease in Dollar Cap.** If the following three conditions are met, then Guarantor may decrease the Dollar Cap to \$[insert amt. that is one-half of initial dollar cap] as of the [insert date, e.g., the first anniversary] of the Commencement Date (as defined in Clause [insert #] of the Lease):
- (i) Landlord receives from Guarantor a written notice, at least [insert #, e.g., three (3)] months, but not more than [insert #, e.g., six (6)] months, prior to the [insert date, e.g., the first anniversary] of the Commencement Date, demanding that the Dollar Cap be reduced to \$[insert amt.];
 - (ii) Guarantor has not defaulted under any term of this Guaranty on or prior to the [insert date, e.g., the first anniversary] of the Commencement Date; and
 - (iii) Tenant has not defaulted under any terms of the Lease on or prior to the [insert date, e.g., the first anniversary] of the Commencement Date.
- c. Elimination of Dollar Cap.** If the following three conditions are met, then Guarantor may decrease the Dollar Cap to zero as of the [insert date, e.g., the fifth anniversary] of the Commencement Date (as such term is defined in the Lease):
- (i) Landlord receives from Guarantor a written notice, at least [insert #, e.g., three (3)] months, but not more than [insert #, e.g., six (6)] months, prior to the [insert date, e.g., the fifth anniversary] of the Commencement Date, demanding that the Dollar Cap be eliminated;
 - (ii) Guarantor has not defaulted under any term of this Guaranty on or prior to the [insert date, e.g., the fifth anniversary] of the Commencement Date; and
 - (iii) Tenant has not defaulted under any term of the Lease on or prior to the [insert date, e.g., the fifth anniversary] of the Commencement Date.
- d. No Release.** Neither the decrease in the Dollar Cap in accordance with Paragraph b hereof nor the elimination of the Dollar Cap in accordance with Paragraph c hereof will constitute a release or discharge of Tenant or Guarantor with respect to:
- (i) Any obligation or liability that is outstanding or unsatisfied as of the date of the decrease in the Dollar Cap in accordance with Paragraph b hereof or as of the date of the elimination of the Dollar Cap under Paragraph c hereof, whether such obligation or liability is unbilled or calculated, accrued or incurred under the Guaranty or the Lease, including, but not limited to, the payment as and when due of Base Rent and Additional Rent (as such terms are defined in the Lease) and any other charges and damages payable by Tenant under the Lease; or
 - (ii) Guarantor's obligation to pay any and all expenses and fees excluded from the Dollar Cap, as required to be paid by Guarantor under Paragraph a hereof.

the guarantor's liability won't exceed a specific dollar amount, excluding certain costs, he says [Clause, par. a]. This way, the guarantor is responsible for payments up to that amount, and the tenant's previous rent payments won't be applied to the cap.

Safeguard #4: Set three conditions for each decrease. Don't allow a dollar cap decrease unless the following three conditions are met, says Ripp. Note that these conditions must be met each time the dollar cap is scheduled for a decrease, he adds:

a. Guarantor must give notice. Condition each dollar cap decrease on the guarantor's sending you written notice demanding such decrease. You should require this notice within a limited time period before the decrease is scheduled to take effect. For instance, you might require the notice at least three months—but not more than six months—before the next scheduled decrease, says Ripp [Clause, par. b(i), c(i)]. If the guarantor doesn't send its notice within that limited time period, the dollar cap won't make the scheduled decrease.

◆ **PRACTICAL POINTER:** A savvy guarantor or tenant will likely ask for a longer time frame in which the guarantor can send its notice, to reduce the risk that the guarantor won't send you the notice on time, says Ripp. You may have to give in on this point if the tenant or guarantor has some negotiating power.

b. Guarantor mustn't have defaulted. Don't let a guarantor that has defaulted under the guaranty in the past or is currently in default take advantage of a dollar cap decrease, says Ripp. Instead, condition the decrease on the guarantor's not having defaulted and not being in default under the guaranty, he advises [Clause, par. b(ii), c(ii)].

c. Tenant mustn't have defaulted. If a tenant has defaulted or is currently default-

ing under the lease, you don't want the guarantor's liability to decrease. Rather, you may need to take legal action against the guarantor to carry out the defaulting tenant's lease obligations. So condition the dollar cap decrease on the tenant's also not having defaulted and not being in default under the lease, says Ripp [Clause, par. b(iii), c(iii)].

◆ **PRACTICAL POINTER:** Expect a savvy tenant or guarantor to argue that the second and third conditions should require only that the guarantor and tenant not commit a "material"—that is, important—default or a monetary default (exceeding a certain dollar amount) under the guaranty or lease. Otherwise, a minor default—such as not following the proper procedure for mailing a notice could block the dollar cap decrease. You may have to give in on this point. Also, the tenant might argue that if it cures—that is, fixes—its default within the time period required by the lease, the dollar cap decrease must still occur. But to avoid getting burned by a tenant that habitually defaults and cures, place a limit on how many times in a year the tenant can default and then cure its default before the decrease will be blocked.

Safeguard #5: Tenant and guarantor stay on hook for unpaid obligations. Say in the guaranty that the dollar cap decreases won't release the tenant or guarantor from:

- Any debts—such as base rent or additional rent—still owing as of the date that the dollar cap is eliminated, even if those debts weren't billed yet; or
- Guarantor's obligation to pay all of your attorney's fees to enforce the terms of the guaranty, environmental contamination fees, and losses you suffered because of the tenant's negligent or intentional conduct [Clause, par. d].

GET RIGHT TO DEMAND ALTERNATIVE SECURITY IF GUARANTY BECOMES WORTHLESS

A lease guaranty is only as good as the guarantor who stands behind it. And while the individual or corporate guarantor may be viable and creditworthy when the lease is signed, a lot can happen over the course of the lease. For example, a corporate or individual guarantor may have financial troubles and declare bankruptcy, an individual guarantor may die, or a corporate guarantor may dissolve.

Whatever the change in the guarantor's status, you face a grim reality: The guaranty you've been relying on is now essentially worthless. The guarantor can't—or won't—fulfill the lease obligations if the tenant doesn't. And if your lease is like many we've seen, it will offer you no protection in this situation.

But there is an innovative strategy that you can use to protect yourself when signing a lease that's backed by a guarantor: Give yourself the right in the lease to demand alternative security from the tenant if you discover that the guaranty has become essentially worthless due to a guarantor's change in circumstances, says New Jersey attorney Marc L. Ripp. That is, make the tenant provide some other security instead of the guaranty to ensure that it will be able to pay its lease obligations, he says.

What Changes Trigger Alternative Security Requirement?

To use this strategy, there are several issues you'll need to negotiate with the tenant. First, you'll want to agree on a list of changes in the guarantor's circumstances that will make the guaranty unacceptable—and will trigger the requirement to give alternative security. Here's what Ripp suggests:

Guarantor's creditworthiness drops. Normally, when you accept a guaranty, the guarantor is in better financial shape than the tenant. But what if an individual or corporate guarantor's net worth plummets? Most leases say that the guaranty will still be enforceable even if the guarantor becomes insolvent. But if the tenant fails to fulfill its lease obligations, you can't collect on a guaranty from an insolvent guarantor. So make sure you have the right to demand alternative security if, in your sole judgment, the guarantor's creditworthiness falls

below a level that's acceptable to you, Ripp suggests [Clause, par. a(i)].

◆ **PRACTICAL POINTER:** The tenant may insist on setting a dollar amount threshold for its net worth instead of relying solely on your judgment about its creditworthiness. That is, you may demand alternative security only if the guarantor's net worth falls below, say, \$500,000. You may have to agree to this point.

Guarantor goes bankrupt. Most leases say that the guarantor's obligations won't be discharged even if it goes bankrupt. But in reality, a bankrupt guarantor will force you to stand in line with all the other creditors to get your money—and it's unlikely that you'll ever collect the full amount owed. In the event of a bankruptcy, you're better off if you have a right to insist on alternative security from the tenant, says Ripp [Clause, par. a(ii)].

Guarantor violates guaranty. Suppose the guarantor violates the guaranty but the tenant hasn't yet violated the lease. For example, the guarantor may send you a letter saying that he has no intention of honoring his guaranty obligations. You'll have to sue the guarantor if you ever need to collect. Even though your guaranty should clearly state that it's unconditional, you may not want to waste time and money going to court to enforce it. In those circumstances, you want the right to instead require the tenant to give alternative security, recommends Ripp [Clause, par. a(iii)].

Guarantor dies. There's always the risk that an individual guarantor will die during the lease. The typical lease says that the guaranty will be binding on the guarantor's heirs. But it's still a good idea to get the right to make the tenant give alternative security if the guarantor dies, Ripp advises [Clause, par. a(iv)]. Some states will let you collect from the deceased guarantor's estate, but this can become very complicated—especially if the tenant doesn't violate the lease until years after the guarantor has died. The estate could be drained completely by then, says Ripp.

Guarantor dissolves. There's also the risk that a guarantor that's a corporation, partnership, or limited liability company will dissolve during the lease, says Ripp. When a company dissolves,

it winds up its affairs, distributes its assets, and then stops doing business completely, he explains. The dissolution might be voluntary—for example, the members of a limited liability company might agree to dissolve the company because it's not profitable. Or the dissolution might be involuntary—for example, a state government may decide to dissolve a corporation because it didn't pay its taxes. Either way, although the guaranty may say that it's binding on the guarantor's "successors and assigns," a dissolved company may not leave behind any successors or assigns, Ripp warns. That's why you must get the right to make the tenant give alternative security if the guarantor dissolves, he advises [Clause, par. a(iv)].

What Alternative Security Can You Demand?

There are several forms of alternative security that you can demand, such as:

Cash security deposit. You may want to require the tenant to pay you a cash security deposit—or increase an existing security deposit, says Ripp. To do this, spell out in the lease how much extra the tenant must put up—that is, give a specific dollar amount, he says [Clause, par. c (i)].

Letter of credit. Another choice is to require the tenant to get a letter of credit in an amount that you determine to be appropriate, says Ripp. Also, the terms of the letter of credit should comply with the requirements that you set out in the lease's letter of credit clause [Clause, par. c (ii)]. Many tenants will balk at this choice and argue that letters of credit are expensive and tough to get.

Substitute guaranty. You could instead require the tenant to find a substitute guarantor that you determine is creditworthy. Have the tenant get the substitute guarantor to sign a guaranty that's the same as the guaranty that you attached to the lease as an

exhibit, says Ripp. And require the tenant to give you a copy of the substitute guaranty with original signatures [Clause, par. c (iii)].

- ◆ **PRACTICAL POINTER:** Require the tenant to give you the additional cash, new letter of credit, or substitute guaranty by a set deadline—for example, no later than 30 days after the tenant gets your notice for alternative security, says Ripp [Clause, par. a].

Should You Get Right to Terminate Lease?

Should you demand the right to terminate the lease as soon as the guaranty becomes worthless, without bothering to ask for alternative security? Ripp doesn't recommend this. After all, you don't want the tenant out of the space; you merely want a reliable form of security in case the tenant violates the lease, he explains.

But you should get the right to terminate the lease if you asked the tenant to give you alternative security, but the tenant failed to do so within the time set in the lease [Clause, par. b].

Keep Track of Guarantor's Creditworthiness

It's important to keep track of the guarantor's creditworthiness and of any bankruptcy proceeding filed by or against the guarantor, so you'll know if you're entitled to alternative security, says New Jersey attorney Marc L. Ripp. To do this, have the guaranty require the guarantor to give you a detailed and accurate financial statement whenever you ask for it, he says. Then make sure that you ask for that information periodically, because the tenant's creditworthiness could drop quickly.

The guaranty should also require the guarantor to promptly send you any notice of any bankruptcy proceeding filed by or against it, Ripp adds. Also, make sure the lease requires the tenant to notify you immediately if the guarantor dies or dissolves.

Model Lease Clause: Events Triggering Alternative Security Right

The following lease clause was drafted by New Jersey attorney Marc L. Ripp. It protects you when a tenant has gotten an individual or a company to guaranty its lease obligations. Show this clause to your attorney before putting it in your lease.

ALTERNATIVE SECURITY FOR GUARANTY

a. Events Affecting Guaranty. If, in connection with the Guaranty being executed by Guarantor simultaneously with this Lease:

- (i) Landlord, in its sole judgment, determines that the creditworthiness, economic strength, or financial status of Guarantor falls below a level then acceptable to Landlord;
- (ii) A bankruptcy proceeding is filed by or against Guarantor;
- (iii) Guarantor breaches the Guaranty; or
- (iv) Guarantor [*dies/dissolves*];

then Landlord may, at any time and upon prior written demand to Tenant, require Tenant to deliver to Landlord the Alternative Security (as defined in Paragraph c hereof), within [*insert #, e.g., 30*] days after Tenant's receipt of such written demand;

b. Termination if Tenant Fails to Comply. Tenant's failure to provide the Alternative Security requested by Landlord shall be a material default of this Lease for which Landlord may terminate the Lease on [*insert #*] days' written notice to Tenant.

c. Forms of Alternative Security. The phrase "Alternative Security" shall mean one of the following, as selected by Landlord in its sole judgment:

- (i) \$[*insert amt.*] to be held as additional security;
- (ii) A new letter of credit, in an amount to be determined in the sole judgment of Landlord, which complies with the terms of Clause [*insert # of letter of credit clause*] hereof; or
- (iii) An original of a substitute guaranty agreement, signed by an individual or entity acceptable in the sole judgment of Landlord, having a form identical to that attached hereto as Exhibit [*insert #*] and made a part hereof.

NEGOTIATE THREE LIMITATIONS ON GUARANTOR'S OBLIGATIONS

When a prospective tenant isn't as financially strong or experienced as you'd like, your choices aren't limited to either taking a big risk or passing on an otherwise valuable opportunity. You can secure the tenant's lease obligations by getting a guaranty for additional financial security. If the tenant is willing to provide a third-party guarantor, you'll need to negotiate the scope of the guaranty. It's key to strike a balance between making the guarantor liable for any tenant-caused losses and allowing reasonable limitations on the guarantor's liability.

We'll tell you how to negotiate a guaranty with a fair and balanced scope, and give you a Model Agreement: Carefully Limit Obligations of Tenant's Guarantor, which you can adapt for the guaranty you sign with your tenant's guarantor. You can also use our *Model Agreement: Let Guarantor Off Hook with Written Release of Guaranty*, to release the guarantor from its obligations.

Triggers to Release from Liability

What's a typical owner looking for in a guarantor? "Someone who could make the owner whole—that is, cover the amount of damage—such as lost rent or allowance money—that would occur in the event of a tenant default," says Virginia attorney David S. Houston. But a guarantor will want to take on as little risk and potential liability as possible. Agreeing to release the guarantor from liability at some predetermined point in time or upon the fulfillment of some condition is a good compromise.

"Conditions and reductions of a guaranty are usually negotiated up front between the parties in the terms of the guaranty," says Houston. The guarantor's eligibility to be released or have its liability reduced is usually conditioned on the tenant never being in default," he says. Here are three more conditions that could trigger a release:

Certain time has passed without tenant default. Often, an owner wants a guaranty because the tenant has an unknown track record. Consider limiting the guaranty for a fixed period during the early years of the lease term. If a certain period of time—say, three years—has passed and the tenant has complied with the lease and has sufficient financial strength or business knowledge that you

could look to it alone to perform under the lease, it would be safer to release the guarantor. "In that scenario, your risk has been reduced from the time you first signed the lease, because at that point in time you didn't know what you were going to get from the tenant, and now you know that it's reliable," says Houston [Agr., par. 3].

It's also reasonable to *reduce* the obligations contained in the guaranty at some future point in time or upon meeting some condition—for example, reducing the sum of the guarantor's liability to three months' rent or some agreed-upon dollar amount, says Houston. This is a good compromise if you're still skittish about relying on the tenant alone, and want some additional security that you'll be reimbursed for default-related expenses.

Tenant meets certain net worth requirement. You may feel that, even if your risk of being on the hook for the tenant's default has been reduced by a history of timely payment and compliance, there's no assurance that the tenant's financial situation will be significantly greater at the end of a guaranty period that's shorter than the lease term, or that its good performance will continue into the future. Conditioning the release of the guarantor on the tenant's attaining a certain level of net worth can solve this problem. For example, if the tenant's net worth reaches an amount that you've agreed upon, the guarantor is released. But make sure to specify that, even if the net worth is reached, the tenant mustn't be in default of any lease terms or conditions [Agr., par. 1].

Liability reaches certain limit. Another compromise is to limit the amount of damages the guarantor would owe—for example, setting a maximum sum it would be liable for. This could be a fixed dollar amount or it could be calculated using a method like figuring the sum of the number of consecutive months of annual minimum rent and additional rent being paid by the tenant on the date of its default (including applicable escalations as provided in the lease) [Agr., par. 2].

- ◆ **PRACTICAL POINTER:** Draft the guaranty as a separate agreement in a separate document from the lease. It's often attached to the lease, but the guarantor isn't the tenant, so it's not necessarily a party to the lease itself. Nevertheless, it's standard to include

the words: “the guarantor hereby assumes all the obligations of the tenant.”

No Release for Assignment, Transfer

You have three viable options for reducing or releasing a guarantor for your tenant, but what happens when a tenant decides to exercise its right to assign or otherwise transfer its lease? Assignments or other transfers can pose additional risks for owners; be very wary of leaving yourself vulnerable in this situation by letting the original tenant or guarantor off the hook and having no one to look to if there’s a problem with the assignee.

“As a general rule of thumb, an owner wants to keep as many people on the hook as possible so it can enforce guaranties that would help compensate it

for its entire loss in the event that a tenant defaults,” says Houston. There are several positions that an owner could take when a tenant with an assignment right asks for its guarantor to be released upon assignment. The decision you make depends on whether the request is for an assignment and release of either tenant or guarantor, or both, and the amount of leverage, if any, that the tenant has.

“Generally, the owner wouldn’t let the guarantor out of the guaranty in the event of an assignment, and the guaranty should expressly provide for the guarantor’s obligations to survive an assignment,” Houston notes. “The point of the guaranty is to try to keep as many deep pockets available to you in the event of a default,” Houston stresses. “Because the guarantor is probably the one with the stronger financial credit in the first place, an owner’s first

Model Agreement: Carefully Limit Obligations of Tenant’s Guarantor

If you’re considering renting to a tenant that isn’t as financially strong as you’d like, or is a new business without a track record, negotiate terms that give you the greatest assurances that if the tenant fails to perform under the lease, you won’t be left to cover those expenses on your own. You can do that by requiring the tenant to provide a guarantor that will agree to a guaranty for the tenant’s lease obligations.

Guarantors generally want to take on as little risk and potential liability as possible. You can use the following guaranty language, drafted by Virginia commercial real estate attorney David S. Houston, in your guaranty to help you compromise with the guarantor by limiting its obligations in three ways. Consult your attorney before using this language.

LIMITATIONS ON OBLIGATIONS OF LEASE GUARANTOR

- 1. Net Worth Requirement.** Notwithstanding anything to the contrary hereinabove contained, provided Tenant has not been [*is not*] in default under any of the terms and conditions set forth in the Lease, and provided further that Tenant has a net worth of \$[*insert appropriate amt.*] on the expiration of the [*insert year of lease term, e.g., third*] year of the Lease Term, Guarantor shall be relieved of any and all liability under the terms of this Guaranty arising from and after said date, and thereafter this Guaranty shall be null and void. If Tenant fails to achieve the net worth as outlined above, then this Guaranty shall remain and continue in full force and effect until a net worth of \$[*insert appropriate amt.*] has been achieved.
- 2. Limited Liability Guaranty.** Notwithstanding anything to the contrary hereinabove contained, with respect to a default [*ALTERNATIVE: each default*] by Tenant under the Lease, Guarantor’s liability shall be limited under this Guaranty to the sum \$[*insert amt.*] [*ALTERNATIVE: the sum of [insert #] consecutive months of annual minimum rent and additional rent being paid by Tenant on the date of default (including applicable escalations as provided in the Lease)*].
- 3. Limited Duration Guaranty.** Notwithstanding anything to the contrary hereinabove contained, provided Tenant has not been [*is not*] in default under any of the terms and conditions set forth in the Lease, on the expiration of the [*insert year, e.g., fifth*] year of the Lease Term, Guarantor shall be relieved of any and all liability under the terms of this Guaranty arising from and after said date, and thereafter this Guaranty shall be null and void.

position would be that it won't let the guarantor off the hook, even if it allows the tenant to assign the lease," he says.

Some tenants, especially national tenants or tenants that are vital to create the owner's desired mix for its shopping center, have room to negotiate. The owner's second position might be proposing a compromise. "You would negotiate up front conditions under which the guarantor and the tenant would be released from liability in the event of an assignment, but in most situations this would only happen if the assignee taking over the lease has the financial wherewithal to perform under the lease and pay the rent," Houston says.

Frequently, when the tenant notifies the owner that it wants to assign the lease, the owner looks at the financial statement of the prospective assignee. If the assignee isn't strong enough in the owner's opinion, the owner would seek an additional guarantor. (That would be negotiated as part of the owner's consent to an assignment of the lease. In that case, it could end up requiring an amendment to the lease to confirm the transfer, subject to the new guaranty. There would also be a new, separate guaranty agreement.)

"The owner would want to look at the entire scenario before releasing anybody. If there was an assignment and the assignee had no creditworthiness itself, but has a strong guarantor, the owner could become satisfied with the new guarantor's net worth to the extent it could release or reduce the liability of the original guarantor or the tenant," Houston says. "If an assignee meets some financial threshold or other test, some owners might be will-

ing to release the original guarantor and possibly the original tenant," he adds.

Substitutions for Guaranty

If a highly desirable tenant balks at providing a guarantor, how can you rent to it and still have some additional assurance that you won't be left floundering in the event of a default? There are substitutions for a guaranty.

"Whether the owner gets a guarantor depends on the relative bargaining position of each side," notes Houston. "If the tenant is a use or a name tenant that the owner really wants at the center because it'll upgrade the entire property, it might be willing to take more of a risk to get that name or that tenant, even if the tenant isn't willing to put up a third-party guaranty," he says. A large security deposit could suffice, but usually a tenant without financial strength isn't likely to be able to come up with the cash or other forms of security for a large deposit.

"This is a risk that all owners have to factor in to their decision to allow such a substitution for a guaranty," warns Houston. He suggests looking at the tenant's other locations, business plan, concept, and any other relevant experience that could be an indicator of the likelihood that it'll succeed. Ideally, you want to have a strong guarantor with sufficient means to cover your losses. But that's not always possible. "Sometimes the owner is in the driver's seat, but sometimes it's the tenant who can call the shots, and that's when the owner really has to determine how it'll minimize its exposure," emphasizes Houston.

Model Agreement: Let Guarantor Off Hook with Written Release of Guaranty

When it's time to release a tenant's guarantor, memorialize the release in writing. Ask your attorney about using the following Release of Guaranty.

RELEASE OF GUARANTY

THIS RELEASE OF GUARANTY (this "Release"), made as of *[insert month and year]*, by *[insert name of landlord]* ("Landlord") in favor of *[insert name of tenant's guarantor]* ("Guarantor"),

WITNESSETH: THAT,

WHEREAS, Landlord and *[insert name of tenant]* ("Tenant") are parties to that certain Lease dated *[insert date of lease]*, for certain real property located in *[insert address of office building or shopping center]* and commonly known as *[insert name of building or shopping center]* (the "Lease");

WHEREAS, pursuant to that certain Guaranty dated *[insert date of guaranty]*, in favor of Landlord, Guarantor guaranteed Tenant's obligation under the Lease; and

WHEREAS, in connection with an assignment of Tenant's interest in the Lease that is being effected as of the date first above written, Landlord desires to release Guarantor from its obligations under the Guaranty;

NOW, THEREFORE, in consideration of the premises, Ten Dollars (\$10.00) cash in hand paid, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord hereby releases and discharges Guarantor from its obligations under the Guaranty as fully and completely as if the Guaranty had never been entered into by Guarantor.

IN WITNESS WHEREOF, Landlord has executed this Release as of the date first above written.

LANDLORD:

By: _____

NAME: _____ TITLE: _____