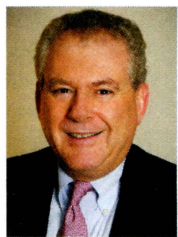


When Bad Guarantees Happen To Good Guys

By Joshua Stein, Joshua Stein PLLC



I promise I'll be a good guy.

If my company occupies space and stops paying rent, then I'll make sure the tenant moves out. The landlord won't have to endure a year or two of potentially baseless litigation, collect no rent in time, and then obtain a judgment against a tenant that can't pay.

Instead, I promise the defaulting tenant will just move out and give back the space. That's what a good guy would do, and I'm a good guy.

How will I do all this? I'll sign a "good guy guaranty"—my promise to pay all the rent due until my company moves out.

That's how the "good guy guaranty" started. It protects the landlord, without imposing ruinous liability on a guarantor if the tenant can't afford the lease or even goes out of business.

Like some other good ideas in the world of guaranties, these guaranties have some surprises and tricks to them. Over time those tricks have gotten trickier — sometimes to a point where "just a good guy guaranty" can bite the guarantor in very unpleasant ways. A tenant's principal shouldn't necessarily sign something just because it's a "good guy guaranty."

The first question to ask: Exactly what must happen for the "good guy" to "get off" the guaranty? Remember the plan was to give the landlord credit support for the rent until the tenant actually left. Once the tenant leaves, the guarantor's exposure should end, right?

Not necessarily. Sometimes, the guarantor's liability keeps growing until the guarantor actually pays whatever the guarantor owes. If the tenant dutifully moves out 15 minutes after default — the goal of the guaranty — but the guarantor can't pay the unpaid rent, then the guarantor's liability keeps building up even though the guaranty has already served its purpose.

A landlord will certainly favor having such an ever-expanding claim, but it goes beyond the premise of a "good guy guaranty." Once the tenant has moved out, the landlord has achieved its goal of having a claim against the tenant's owner for unpaid rent while the tenant was in default.

A careful good guy guarantor can insist that the claim should not keep growing just because the guarantor can't pay it immediately.

The second question to ask: Exactly what must the good guy guarantor pay? The guaranty might, for example, simply cover all payments due under the lease until the tenant moves out. That sounds reasonable. But the lease probably says that upon a tenant default,

the tenant owes a lump-sum payment based in part on the rent due through the end of the lease.

The good-guy guarantor shouldn't have to pay that lump-sum payment or anything remotely like it, even if it becomes due under the lease before the tenant actually moves out.

A "good guy" guaranty should limit the guarantor's liability so it covers only the monthly base rent, and a few other very specific financial obligations under the lease, and only to the extent specifically allocable to the time until the tenant moved out. If possible, the guaranty should not cover the entire canopy of payments the lease might require the tenant to make.

The third question to ask: What about the tenant? Under a typical good guy guaranty, once someone has paid the rent through the tenant's move-out date, the guarantor is off the hook. But the tenant stays fully liable under the lease. That makes perfect sense if the tenant will go out of business once it defaults on its lease. Usually that's a safe assumption.

If, however, the tenant might stay in business — just need to move its business to less expensive space — then a good guy guaranty doesn't help the tenant much. The tenant could still face a huge judgment on the lease, and potentially having the landlord enforce that judgment against the tenant's bank account, equipment, inventory, and other assets.

In these cases, the tenant and the guarantor should probably replace the "good guy guaranty" with an outright termination option for the tenant. The lease would give the tenant the right to terminate at any time, or at some specific times, perhaps by making a payment or giving up the security deposit. The termination would typically require some prior notice.

After that, the tenant would need to pay rent until they actually moved out, but once they moved out no further liability for rent would arise. The transaction could still require a "good guy" guaranty. In the guarantor's opinion, though, that guaranty would cover only rent until the tenant moved out.

By asking the three questions suggested here, and a few others, the principal of a small business tenant can make sure that a bad guaranty doesn't happen to a good guy.

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