Lease Guaranties—A Practical Approach (with Form)

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**Commercial landlords need their rent. A well drafted lease guaranty can ensure that they get it.**

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**THE NEED FOR A GUARANTOR** of a tenant’s lease obligations can arise in a variety of factual situations. However, most of these situations can be simply summarized as follows: the landlord is concerned about the tenant’s economic viability. Accordingly, when circumstances dictate, the landlord will typically look to, and rely on, the credit of a third party in making its economic decision to lease space to the tenant.

This article doesn’t aspire to be an exhaustive discussion of the law of guaranty. That topic has been admirably treated elsewhere. See 7A Patrick J. Rohan, Current Leasing Law and Techniques—Forms, Ch. 7B “Third-Party Guaranties of Tenant Performance” (Matthew Bender 2000); Milton R. Friedman, *Friedman on Leases* (Practising Law Institute, 4th ed. 1997). Instead, this article identifies and discusses the practical issues that you should consider when drafting a guaranty for the landlord.

When sound business judgment dictates the need for a third-party guarantor, it makes little economic sense for a landlord to negotiate a comprehensive lease and then fail to provide an equally comprehensive guaranty. A lease guaranty is substantially similar to and is the economic equivalent of a loan guaranty, and should be treated with similar care and attention to detail. As a consequence of years of litigation and creative counsel for guarantors, there are many traps for the unwary landlord.

**BACK TO BASICS •** A guaranty is a collateral undertaking to answer for the payment or performance obligations of another. 38 Am. Jur. 2d Guaranty §1 (1999). As such, for a guaranty to be enforceable, it will need to be in writing and signed to comply with the Statute of Frauds as adopted in virtually every jurisdiction. See, e.g., Conn. Gen. Stat. §52-550(a)(2) (West Supp. 2000); Restatement (Third) of Suretyship and Guaranty §11 (1996) (“Restatement”).

A guaranty is also subject to the same legal requirements governing contracts generally, not the least of which is that a guaranty must be supported by consideration. See, 38 Am. Jur. 2d Guaranty §41 (1999). Although the Restatement has made some notable policy exceptions (See, Restatement §9), consideration typically will be found when a lease and guaranty are executed simultaneously. *Garland v. Gaines*, 49 A. 19 (Conn. Super. Ct. 1901). When, however, a guaranty was not contemplated at lease signing, and the need for a guarantor arises after the lease is executed, some distinct new consideration (i.e., forbearance under the lease) generally will be required.

The application of these rules suggests:
• That the landlord’s lawyer include the requirement of a guaranty as an express provision of the written lease; and
• That the guarantor acknowledge the guaranty as an inducement to action or inaction by the landlord (leasing, forbearance, etc.).

WHAT ARE THE GUARANTEED OBLIGATIONS? • A landlord must first determine the extent of the guarantor’s liability. In the vast majority of situations the guaranty agreement is and should be an unconditional guaranty of all of the tenant’s obligations. That is, the guaranty will cover not only the tenant’s payment obligations but also its obligation to perform and comply with all of the other terms, covenants, and conditions of the lease.

Given the relative bargaining positions of the parties however, there are numerous ways that landlords may be requested to limit a guaranty. These may include:
• Specific dollar cap;
• Duration cap;
• Step-up or step-down liability;
• A guaranty tied to the tenant’s net worth or gross income; or
• A “good guy” guaranty (liability is limited to lease obligations incurred up to time tenant vacates the premises).

In any event, liability limitations must be carefully drafted because the guarantor’s liability will not typically be extended beyond that which is provided for in the guaranty. As an additional drafting note, ensure that any dollar limitation under the guaranty is exclusive of costs of collection and attorneys’ fees. Otherwise, a landlord may find itself spending more in collection costs than the guarantor is obligated to pay.

DURATION • Assuming that a guaranty is not limited to a stated term, does it necessarily extend to lease renewals, extensions, or holdovers? There is a substantial split of authority when the guaranty is silent on these issues. In the absence of clear language the courts are forced to use standard rules of contract interpretation, such as the intention of the parties or whether the guaranty was a “continuing” or “restricted guaranty.” See, Sponzo v. Gooden, 1995 WL 55080 (Conn. Super. Ct. Jan. 31, 1995) (DiPentima, J.); 38 Am. Jur. 2d Guaranty §58 (1999); Restatement §16. A landlord should not leave issues for a court to interpret. The simple solution is for the guaranty to expressly address these issues and provide that the liability of the guarantor will continue under such circumstances.

GUARANTOR DEFENSES • Over the centuries, the law has afforded a guarantor numerous defenses to avoid payment or performance of guaranteed obligations. Many of these defenses are based on post-execution conduct that “alters” the guarantor’s obligations in some manner. Some of the more notable defenses are:
• Modification of lease obligation;
• Release of security or of another party;
• Impairment of recourse; and
• Waiver and release by assignment, sublease, or tenant bankruptcy. See generally, Restatement §§37-49.
Despite these numerous potential defenses, both the common law and the Restatement now provide specific authority for the simple waiver of suretyship defenses. Restatement §48. To protect the economic expectations of the landlord, the guaranty must address these well established defenses and specifically provide for their waiver. Nevertheless, prudence dictates that whenever possible a landlord should obtain the guarantor’s written consent before undertaking any action that may be construed as affecting the guarantor’s liability.

AUTHORITY • If the guarantor is an entity, the landlord’s lawyer must insure that both the entity and the person signing the guaranty on behalf of the entity are authorized to do so. The guaranty should be signed with the same formalities as the lease, and the signatures should be acknowledged when appropriate.

WAIVER OF JURY TRIAL • The same considerations that suggest the inclusion of jury trial waivers in a lease (i.e., delay, cost, and potentially sympathetic juries) are equally applicable, if not more so, to a guaranty. A landlord is in need of cost-effective and expeditious resolution of any litigation. If permitted in your jurisdiction, specific and conspicuous language must be included for the waiver to be upheld. See, Connecticut Savings Bank v. Quinlan, 1995 WL 371046 (Conn. Super. Ct. June 14, 1995) (Hadden, J.).

JOINT AND SEVERAL LIABILITY • If there is more than one guarantor, the guarantors’ liability should be joint and several.

FORUM SELECTION AND CHOICE OF LAW • The guaranty should include a forum selection and choice of law provision especially if the guarantor is located in a different jurisdiction from the landlord.

SUCCESSOR AND ASSIGNS • The guaranty should always run in favor of the landlord’s successors and assigns as well as actual or potential mortgagees.

CONCLUSION • A guarantor is often the only real party of any economic value to the landlord when the tenant defaults. A poorly drafted guaranty will inadequately protect and preserve the landlord’s economic expectations. The contents of the guaranty must not be an afterthought and the drafter must exercise appropriate levels of care and diligence in the preparation and negotiation of any lease guaranty. Appended below is a model lease guarantee that reflects the issues discussed in this article.