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The Good Guy Guaranty: A Unique New York Institution The Benefits and Pitfalls

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The COVID-19 virus has caused many landlords and tenants to take a close look at their leases to determine how those leases hold up in a COVID-19 economy. What can be done to secure relief from rent numbers that reflect a pre-COVID-19 market? What can be done to retain a tenant or secure a tenant in an unsettled market? Whether you are trying to get out of a lease, enter into a lease or retain a tenant, this process may start with understanding a unique New York agreement: the “good guy guaranty.”

While good guy guaranties will be more and more popular in a post-COVID-19 real estate market, as capital is scarce and tenants are scarce, the New York City Council may have had good guy guaranties in mind when, just this week, the Council enacted legislation that prohibits the enforcement of a personal guaranty, if (i) the liability arose between March 3, 2020 and September, 30, 2020 and (ii) tenant was materially impacted by the COVID moratorium.¹

This legislation was enacted by the City Council and remains subject to approval by Mayor De Blasio. Regardless of the fate of this legislation, good guy guaranties are likely to be with us for many years.

What are the benefits and pitfalls of a good guy guaranty? A good guy guaranty may:

- Reduce the amount of security that a tenant might otherwise have to provide to secure a lease;
- Offer an alternative to the tenant principal to guarantying performance of a lease for its entire term; and
- Provide the landlord with security and comfort that the rent will be paid to the date the landlord recovers possession of the premises.

Lease obligations can often run into the millions of dollars, potentially bankrupting a guarantor, (often the principal of the tenant), while a good guy guaranty provides the guarantor with

¹ One of the following conditions must be met to invoke the benefit of this City statute: “1. The tenant satisfies the conditions of subparagraph (a), (b) or (c):

(a) The tenant was required to cease serving patrons food or beverage for on-premises consumption or to cease operation under Executive Order Number 202.3 issued by the Governor on March 16, 2020;

(b) The tenant was a non-essential retail establishment subject to in-person limitations under guidance issued by the New York State Department of Economic Development pursuant to Executive Order Number 202.6 issued by the Governor on March 18, 2020; or

(c) The tenant was required to close to members of the public under Executive Order Number 202.7 issued by the Governor on March 19, 2020.”

comfort that she can control, in large part, the extent of her liability.

The good guy guaranty arose from the morass of the overburdened landlord and tenant court system. The essence of a good guy guaranty is found in the name: Be a “good guy.” Get out if you cannot pay. Do not take advantage of the legal system by remaining in a space for months, and, sometimes years, while not paying rent; with the result that, eventually, a landlord recovers possession of the premises, but has a large, unsatisfied judgment for unpaid rent without a solvent party from whom to collect the deficiency. A good guy guaranty motivates the tenant to return possession to the landlord promptly when she cannot continue to pay the rent.

In the course of negotiating leases, landlords are willing to take less security when a tenant offers a good guy guaranty. With a good guy guaranty, those who control the tenant are motivated to return possession to the landlord as the principal/guarantor may be liable for the rent deficiency until the tenant delivers possession to the landlord.

Under the accepted structure of a good guy guaranty, the guarantor’s liability ends when the guarantor or the tenant satisfy the conditions set forth in the good guy guaranty. For example, such conditions may include (i) paying the rent and all other obligations under the lease to the date of surrender, (ii) leaving the premises in the condition required under the lease, (iii) giving landlord proper notice of its intention to surrender the premises as defined in the guaranty and surrendering possession to the right party.

What many good guy guarantors do not realize is that only the guarantor is released from liability when the tenant or guarantor satisfies all the conditions of the good guy guaranty. The tenant continues to be liable under the lease; but, assuming the tenant has limited assets, a

judgment against the tenant may be of little concern to its principals.²

As with any document that is the product of negotiation, good guy guaranties, if not properly drafted, may extend the guarantor’s liability far beyond what the guarantor might expect:

Do Not Enter a Good Guy Guaranty Unless You Know How to Get Out

The danger of a good guy guaranty lies in the situation where the tenant or the guarantor is prepared to return possession to the landlord, but it not prepared or not able to satisfy the conditions to complete the surrender and terminate the guarantor’s liability.

Maintain Control of the Tenant If a guarantor loses control of the management of the tenant, the guarantor may find herself in an untenable situation: she may be unable to stop the accrual of unpaid rent and other leasehold obligations and watch, essentially, without an effective remedy, as the tenant remains in the premises and the guarantor’s liability grows.³

Thus, before an individual agrees to guarantee a lease, she must be certain that she will *never* lose control of the tenant as long as the guaranty is in place. Indemnities from others are helpful, but they may not be sufficient, as, often, an indemnity is just a cause of action against another person or party.

Similarly, if the guarantor is not in control of the tenant, the guarantor should think very carefully about whether she should guarantee the tenant’s

² Note, however, that if a landlord secures a judgment against a tenant, it may seek to pursue an action for fraudulent conveyance or an action to pierce the corporate veil in an attempt to reach the principals or the parent entities.

³ Of course, if the guarantor loses control of the tenant, she may seek judicial relief, but, as we all know, litigation takes time, is costly and a court may not direct a tenant to vacate a premises merely because the guarantor’s liability will continue.

obligations. Obviously, unless the guarantor has ultimate control of the tenant, the guarantor could be fired. If the guarantor is entering into a business with partners, and is removed from decision-making authority, or if the guarantor, as an employee of an entity, is fired, the guarantor stands on the sidelines and watches, helplessly, as her obligations grow with each unpaid monthly rent obligation, much like a runaway train.

Best Practices:

- Do not become a good guy guarantor without ensuring that you will retain the ability to surrender the premises to the landlord for as long as you are the guarantor.
- If, nevertheless, one decides to sign a good guy guaranty, make sure the guarantor is indemnified to the extent of her personal liability from a party that has the authority to surrender possession and make sure that party has sufficient assets to reimburse guarantor for her liability, including attorneys' fees.
- Include in the guaranty a pathway to exit liability such as: "(i) Guarantor's liability under the good guy guaranty shall cease (to accrue) at such time as she no longer holds her current position in the tenant and notifies landlord of such event. (ii) Guarantor shall no longer have liability hereunder, in the event that tenant shall deliver to landlord a good guy guaranty in the form herein executed by a guarantor with the same or greater net worth than that of the good guy guarantor executing this guaranty."

Quantify and Clarify the Good Guy Guarantor Liabilities

The appeal of a good guy guaranty is lost if the liability is too much for the guarantor to discharge, either because she does not have the funds to discharge the liability or because the liability is uncertain. Remember, most guaranties continue to extend the guarantor's liability until

all of the obligations are fully discharged.⁴ Thus, if a good guy guaranty has the relatively benign language: "The guarantor guaranties all rent and additional rent under the lease until the date of surrender," the liability of the guarantor may be far greater than the guarantor may realize.

For example, Rent and Additional Rent include what we can anticipate: base rent, taxes, operating expenses; but Rent and Additional Rent may also include: damage to the building caused by a tenant casualty, slip and fall judgments not covered by insurance, litigation costs not otherwise compensated, accelerated rent, and judgments arising from tenant's conduct, such as hazardous waste contamination.

In addition, many leases provide that a landlord may accelerate the balance of the rent due under a lease upon the occurrence of a default. Thus, if a tenant is late in payment of its rent, for as little as one month, a landlord might accelerate the rent; and, if the good guy guaranty has not been discharged, the landlord may attempt to impose upon the guarantor the entire burden of the accelerated rent.⁵

Landlords may also fold into the Guarantor's obligations repayment of brokerage fees, abated rent and other transaction costs. Tenants should try to resist such efforts, remembering that the

⁴ The thinking behind this position is that the tenant is already walking away from the lease and defaulting thereunder. The landlord should not have to sue the guarantor to secure the funds that the guarantor has promised to pay.

⁵ Surely, making the good guy responsible for all of the obligations of the tenant under the lease would not have been the intent of the parties, but, often, in clearly drafted documents, courts look to the language as stated by the words of the document; and if the words vary from the intent, a court will not so readily disregard the words and be bound by the unwritten intent, resulting in the imposition of far greater liability on the good guy than the guarantor could have anticipated when entering into the guaranty.

initial motivation for the good guy guaranty was the return of possession of the premises should the tenant not pay rent.⁶ Moreover, if the additional obligations are too much for the guarantor to pay, then such number may constitute an obstacle to an effective surrender.⁷ In such event, the guarantor will be faced with the odd situation in which the guarantor does not have the money necessary to meet the conditions required to end the guaranty, resulting in the continued accretion of her liability.

Similarly, if the premises has accumulated violations due to faulty or unauthorized construction or unpaid construction costs, the cost of discharging those liabilities and the time needed to cure the violations may be swept up into the obligation of the good guy guarantor, further delaying the guarantor's discharge. Until the liability is discharged, the obligations continue.

Best Practices:

- When signing a good guy guaranty, define the scope of the guarantor's liability. Rather than accept liability for all rent and additional rent, state explicitly the guarantor's obligations. For example, "Guarantor shall be liable for Base Rent (as defined) and Additional Rent, to include only real estate taxes and operating expenses due to the date

⁶ If a tenant must expand liability of a good guy guaranty to transaction costs, at a minimum, make sure they are amortized over the term of the lease so that the transaction costs in the event of a default in year one are not the same as they would be if a default arose in the last year of the term of the lease.

⁷ Do not enter into a good guy guaranty with the expectation that the security can be applied to the guarantor's obligations under the guaranty. Most good guy guaranties prohibit the application of the security to reduce the obligations set forth in the guaranty. The security is applied to the post-possession deficiencies which often greatly exceed the amount of the security.

of surrender, explicitly excluding any accelerated rent."

- Try to exclude liability for damage to the premises or the building or any liability beyond the rent and additional rent charges included above: "Guarantor shall not be liable for any claim of damages for negligence or casualty to the premises or Building or accelerated rent."⁸
- Try to limit the notice period required for termination of the good guy guaranty. Obviously, the less notice that is required, the more flexibility the tenant has to surrender when it appears that business is taking a nose dive.

Know What Tenant Must do to Surrender the Premises and Terminate the Guarantor's Liability

Most good guy guaranties dictate the condition in which the premises must be returned in order to end the guarantor's liability: "All Fixed Rent and Additional Rent and other charges payable by Tenant under the Lease (hereinafter collectively referred to as "Accrued Rent"), up to and including the Surrender Date." But what does that mean? A typical lease may also provide "The Tenant shall vacate and surrender the Demised Premises to Landlord free of all subleases, licensees, tenancies, or claims of right therein and in broom clean condition, personal property and trade fixtures removed..."

Thus, the tenant/guarantor is faced with the question of what to take from the premises in order to return it to "its condition as required under the lease on surrender of the premises."

One must know the distinction between fixtures and personal property. If a tenant removes

⁸ The tenant will argue that landlord and tenant insurance will cover those liabilities. Landlord may simply refuse to narrow the scope of the guaranty or argue that the guarantor should be liable to the extent that insurance does not cover the loss. The outcome depends upon the negotiation position of both parties.

something that is personal property and the landlord claims it is a fixture, the landlord could claim that the tenant has failed to deliver the premises “in the condition required under the lease,” and seek to continue the guarantor’s liability under the good guy guaranty.

In essence, unless the guaranty states that the tenant must leave all its personal property, the tenant may take its personal property, trade fixtures, decorations and those items that can be removed from the premises without damage to the structure.⁹

But what about ceiling fans, or lighting affixed to the ceiling or walls? What about your imported French bistro which is installed as the bar, with your expensive and attractive period mirrors? Can you remove them? First, look to the language of the lease and the guaranty to see if these items are addressed directly. If not, then look to the definition of trade fixtures: Are the items “reasonably related to and necessary for the business purpose for which the building was constructed?” Will the removal of the items cause material damage to the Premises? ¹⁰ If the answer to these questions is in the affirmative, the items may constitute fixtures and the tenant may be obligated to leave them in the premises.

Ultimately, a guaranty is a contract and, if a tenant or guarantor is uncertain about what you may remove and what you must leave, remember that courts, when looking to see if a party to a contract is in default, looks to whether the party

has substantially complied with the contract.¹¹ A good guy guaranty does not operate as a “gotcha clause” which would continue to impose liability on a guarantor after the guarantor surrenders possession of the premises in a manner that reflects a good faith effort to substantially comply with the terms of the guaranty.¹²

Finally, to whom does the tenant surrender the premises? The tenant must surrender all rights to the premises, free of all tenants and occupants. Surrendering the keys to the proper party is a start, but it may not be enough. The tenant must surrender the keys to the landlord or its authorized representative. Surrendering to the superintendent of the building might not be sufficient.¹³ The surrender must be complete upon delivery of the keys and the surrender must be to someone who has authority to accept return of the premises. And if the tenant falls short in meeting the conditions of the good guy guaranty, her liability thereunder may continue.

Best Practices:

- Put the premises in the condition required under the Lease and the guaranty.¹⁴ Usually, that condition is the same, but, if they differ, follow the terms of the guaranty. If a tenant is not certain what to take and what to leave, ask the landlord for guidance. If the landlord refuses to give guidance and, later, claims that tenant did not comply with the guaranty,

⁹ One court has described fixtures as “[an item] is installed in such manner that its removal will result in material injury to it or the realty or where the building in which it is placed was specially designed to house it or where the installation is of a permanent nature...” *Whitehall Corners Inc. v. State*, 210 A.D.2d 398, 620 N.Y.S.2d 126 (Ct.Cl. 1994), *City of New York v. Kaiser Woodcraft Corp.*, 39 A.D.3d 131, 837 N.Y.S.2d 2 (1st Dept. 2007).

¹⁰ *NY.S. Decorative Fixture Co. v. V.J. Enterprises*, 57 A.D.2d 890, 594 N.Y.S.2d 278 (2d Dep’t 1977).

¹¹ “An omission, both trivial and innocent, will sometimes be atoned for by the allowance of the resulting damage and not always a forfeiture.” *Jacob & Young v. Kent*, 23 N.Y. 239 (1921)(Cardozo, J.).

¹² *E.g., TAG 380 LLC v. J.P.Morgan Chase Bank*, 12 Misc.2d 172, 820 N.Y.S.2d 846 (NY Co. 2006).

¹³ *115 West 27th Street v. Perez*, Slip. Op. 31588 (N.Y.Co. Sup. Ct. 2016), 9 AD3d 142.

¹⁴ If the tenant plans to install a particularly expensive improvement such as an imported bar or light fixture, clarify in the lease that such item may be removed at any time during the term of the lease without liability to the landlord.

the tenant may assert, as a defense, that the landlord is estopped from objecting as Landlord did not make its objections known when asked by tenant.

- Make sure tenant surrenders the keys to the proper party. Deliver a set of keys to the superintendent or manager of the building, but also deliver keys to the office of the managing agent or landlord, directly.¹⁵ Do not keep a set of keys with the expectation that tenant may re-enter the premises to retrieve a forgotten item.
- Include with the keys a signed writing stating quite clearly that tenant is surrendering possession of the premises to landlord at that moment and abandoning whatever property remains free of all occupants.¹⁶
- Make sure tenant or guarantor has paid all moneys due under the lease to the date of surrender. Remember, if tenant pays less than the sum that is due or remains in the space after surrender, the surrender may be construed as a nullity. Remember, too, the tenant will be liable for its rent obligations for the entire month in which it remains in possession of a premises even if the surrender occurs on the first day of the month.

Walking Away from a Lease

One final point: In the uncertain age of COVID-19, the possibility of walking away from a lease is more real than normal (whatever that might be). Depending upon the value of the location and the

value of the tenant's sunken costs, a tenant may find it more attractive to simply walk away and start new somewhere else. If a tenant has that decision in mind, the tenant should give the notice of surrender sooner than later so that the notice period, cutting off the liability of the good guy guarantor, passes during the period the tenant is negotiating with the landlord.

Once tenant gives the notice of intent to surrender, the notice period in the guaranty starts to run and tenant stops accruing rent obligations beyond the notice period.

By giving the good guy notice sooner than later, the tenant may generate pressure on the landlord to strike a deal before the tenant vacates the premises. This consequence may be critical in a tenant scarce market, such as the one we may be about to enter.

Of course, if the tenant gives the good guy notice, tenant must be prepared to surrender the premises at the end of the notice period if the landlord and tenant do not agree to a rescission of the notice at a later date.¹⁷

Conclusion

Good guy guaranties provide a reasonable balance between the landlord's need for security and the tenant's desire to preserve capital. However, as with most major commitments one makes for any significant period of time, the guarantor should not step into the guaranty unless she knows, going in, how she is going to get out!¹⁸

¹⁵ If a tenant delivers the keys to the wrong party, a court may find that surrender was never achieved. *115 West 27th At. v. Perez*, N.Y. Slip Op. 31588 (NY Co. 2016).

¹⁶ Free of all occupants means free of tenant and subtenants and any other persons in possession or occupancy of the premises. If a subtenant or occupant does not vacate a premises, then the liability of the good guy guarantor continues until all persons have been removed from the premises.

¹⁷ Notice of termination is irrevocable without Landlord agreement otherwise. *Morton's of Chicago/Great Neck LLC v. Crab House, Inc.*, 297 A.D.2d 535, 746 N.Y.S.2d 317 (2d Dept. 2002).

¹⁸ Marriage excepted, perhaps...

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