THE "GOOD GUY" GUARANTY: A BACKSTOP FOR LANDLORDS

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A landlord may request a principal of a tenant to guaranty a lease if the prospective tenant has a less-than-ideal credit profile. In a tenant-friendly market, few landlords will be successful in this pursuit. Consequently, a savvy landlord may request a sufficient security deposit, plus a "Good Guy" Guaranty from a principal or affiliate of the tenant.

For starters, a Good Guy Guaranty in its simplest form is not intended to be a full blown personal guaranty. It is a limited guaranty by the principals of a corporate or LLC tenant that legally enables a landlord to pursue the guarantor only in the event that the tenant stops paying rent and refuses to vacate the space. If the tenant gives sufficient notice of its intent to prematurely vacate the premises before the end of the term and the rent is paid through the date the space is vacated; then the guarantor has no liability.

Here's how it works. If you're a tenant and your business fails but you vacate your office space and pay the rent through the date you vacate, you're a "good guy." You have behaved yourself; the landlord can re-let the space and if there are assets left in the tenant corporation or LLC, the landlord is free to go after them. But so long as the tenant is a "good guy" and vacates the space and pays the rent through the date it vacates the property, the Landlord has no further recourse under the guaranty and is precluded from piercing the protection of the corporate veil of the tenant.

However, if after a business failure, the tenant stops paying rent and fails to vacate the leased space, therefore forcing the landlord to pursue an eviction (something that can take months or longer), the tenant is then a "bad guy." Under the terms of a Good Guy Guaranty, the landlord can now pursue the guarantor for the full amount of the rent. From the tenant's perspective, the Good Guy Guaranty makes staying in an unpaid space extremely unappealing with greater liability exposure to the guarantor. The "good guy" is incentivized to vacate the premises in a timely manner. From a landlord's perspective a Good Guy Guaranty is an insurance policy against the amount of time it can take to evict a tenant. During that time, the landlord can't rent the space or recoup any of its losses.

Sometimes the landlord's perception of what obligations should be covered by a Good Guy Guaranty can be very different than the prospective tenant's and guarantor's view.

Most landlords, tenants, and guarantors agree on the basic premise for a Good Guy Guaranty, namely that its purpose is to (1) incentivize the tenant to vacate the premises in an agreed upon manner by a specified date, and (2) ensure that all accrued rent is paid up to the date of the tenant leaving. The Good Guy Guaranty attempts to achieve these objectives by making the guarantor liable for rent that accrues under the lease up to the date that the tenant actually vacates the premises and leaves the premises in the condition required under the lease. In states such as New Jersey that obligate a commercial landlord to mitigate damages arising from a defaulted lease, the tenant's, guarantor's, and landlord's interests are all served by having the defaulting tenant turn over the premises to the landlord so that the landlord may seek a new tenant as soon as possible.

What is guaranteed? Landlords will typically insist that the guaranteed obligations include unpaid fixed rent and additional rent such as real estate taxes and CAM accrued to the date of vacating. This is often a point of negotiation. Landlords also want the Good Guy Guaranty to be a guaranty of performance as well as payment. This can be very expensive. The guaranty would extend to the non-monetary covenants such as requiring the removal of alterations and repair/restore obligations if not properly negotiated. Tenants often fight long and hard on this point.

What is the vacate date? While this question seems simple enough, it is anything but. Both the landlord and the guarantor start out

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with the same objective: to establish a date by which the tenant must (1) turn over the keys to the premises and (2) vacate and surrender the premises in the condition required by the terms of the lease. Both landlords and guarantors generally agree that the guarantor should be liable for all accrued rent that is unpaid by such date, i.e., the "vacate date." The guarantor's preference is for the vacate date to be defined as the date it turns over the keys, so that the guarantor's obligation for any unpaid accrued rent ends as of that "vacate date." Some landlords, however, will try to include in the definition of the "vacate date" (i.e., the date that determines guarantor's liability) as the date by which tenant both pays to landlord all accrued rent and has abandoned the premises.

Is there a notice requirement? Yes. All parties agree that that the landlord is entitled to advance notice of the date that the tenant intends to vacate the premises. The negotiation is often about how much advance notice is required – anywhere from 3 months to a year. This advance notice gives the landlord the opportunity to begin planning for the marketing and re-letting of the premises. A point of contention, however, is the legal significance of the tenant's failure to provide timely notice of the date of vacating. Aggressive landlords will insist that the tenant's failure to vacate on or before the date specified in the notice should be a default under the Good Guy Guaranty making the guarantor fully liable for the rent for the entire term.

Should the security deposit be applied to the guaranteed obligations? Many landlords view the security deposit as additional collateral for the tenant's obligations under the lease. Accordingly, landlords routinely require that the security deposit not be applied to the obligations guaranteed under the Good Guy Guaranty. This may be a hard pill to swallow for the guarantor, since the guarantor's funds and the tenant's may be interchangeable. If the purpose of the security deposit is to cover the defaulted rent up until the date the tenant vacates, the guarantor will argue, why should the guarantor also be liable for that same rent? Would the landlord be double-dipping? To the extent the tenant has sufficient leverage in the negotiations, it may be able to require that the landlord apply the security deposit to the guaranteed obligations.

All parties should develop a clear understanding at the early stages of the lease negotiations of what the Good Guy Guaranty should and should not provide. The parties may discover that the simple reference to a "Good Guy Guaranty" in a letter of intent or term sheet means something significantly different to one of the parties than the other originally contemplated. One measure would be including the basic provisions of the Good Guy Guaranty in the letter of intent. Another would be an agreement to simply increase the amount of the security deposit provided under the lease.

As with most negotiated points in a commercial real estate transaction, the resolution of these issues will depend on the relative bargaining power of the parties.

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