

"How Can a Landlord Avoid Losing Its Rights Under a Guarantee?"

1. Background

The careful landlord often requires a personal guarantee from a third party as a condition to entering into a lease with a tenant, especially if the tenant is a newly-formed business, one with a thin operating history or one that is financially shaky. The landlord wants to make sure that it has a solvent third party to sue if the tenant defaults.

2. The Problem

If the landlord and tenant modify the lease in a manner that increases the tenant's (and, as a result, the guarantor's) liability, or if the tenant, with the landlord's consent, assigns its lease rights to a third party, the landlord may lose its right to sue the guarantor for the tenant's (or assignee's) breach of the lease.

For example, if the landlord and tenant amend the lease to double the amount of leased space and double the rent, the guarantor can argue that it never agreed to guarantee such an increased obligation. The court hearing such a case will likely hold that it is unfair to enforce the guarantee against the guarantor under those circumstances. Of course, if the guarantor consented to the modification, then the guarantor loses this argument.

3. Factors Considered by Courts

In considering whether a lease modification will result in the loss of the landlord's rights under the guarantee, the courts have broad discretion. The key factors they look at are:

- Has the guarantor received any benefit in exchange for the guarantee? If the guarantor receives no benefit from the guarantee, the courts will be less likely to enforce the guarantee. If, for example, the guarantor is the parent or a friend of one of the business owners but has no financial stake in the business, the guarantor will probably be considered to be an uncompensated guarantor. If, however, the guarantor is one of the business owners, the guarantor will

POSTED:

Mar 30, 2008

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probably be considered to be a compensated guarantor.

- Is the increase in the tenant's obligation material? If the increase in the tenant's obligations is so small as to be immaterial, the courts will be more likely to enforce the guarantee.
- Did the guarantor have control of the management or operation of business? If the guarantor is a principal (owner, partner, shareholder, officer, director, etc.) of the tenant, the courts will be more likely to enforce the guarantee.

4. How to Avoid the Problem

To avoid the issue altogether, the prudent landlord will:

- Draft its lease guarantees in a manner that identifies and documents the existence of some type of benefit to the guarantor as a result of the transaction. Even if the benefit to the guarantor is nothing more than the prospect of increased familial harmony, that should be mentioned.
- Enter into a lease amendment with its tenant ONLY with the written consent of all guarantors. If the guarantors consent to the lease amendment, the landlord can then avoid the guarantor's defenses identified in Section 3, above.
- Grant consent to an assignment of tenant's rights under the lease ONLY with the written consent of all guarantors.

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