



Anatomy and Negotiation of the Good Guy/Bad Guy Guaranty

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January 2016

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Anatomy and Negotiation of the Good Guy/Bad Guy Guaranty

Presented by John B. Wood

I. History of a Limited Good Guy/Bad Guy Guaranty - What is a limited “Good Guy/Bad Guy Guaranty” and how does it differ from the standard Guaranty of Payment and Performance or Guaranty of Collection – Non-standard use of terms, definitions or agreement on uniform attributes in the United States consist of the following general topics:

1. Originally introduced in the late 1970s because of increased costs and expenses associated with tenants holding over in space after default and terminations while not paying or performing under the Lease. The instrument was given by the controlling member or members (shareholders) of the tenant entity and substituted with new controlling members in the event of assignment or change in ownership of the tenant entity. The intent was to make the tenant remove from the premises by exerting financial pain on the controlling decision maker(s) with the power to effect such removal action.

2. Eviction or disposing recovery of space could in many jurisdictions take up to 2 years to evict a defaulting tenant while being required by common or statutory laws to provide services and electricity to the premises.

3. Created to “incentivize” good behavior (punish bad behavior) and avoid the largest budget problem of legal fees and costs to obtain possession of the space and remarketing it. Space is difficult to re-market when ability to deliver it free of the holdover tenant is uncertain. Also if holding over no longer was a free sport, then most holdover events would be much shorter in duration.

4. Loss of rental and re-rental being the biggest concern of the landlord and inducement of the controlling shareholder(s) to remove the holdover tenant being paramount. May be in addition to traditional unlimited payment and performance guaranty and can be layered or joint and several for multiple owners of tenant – but must be issued by the continuing controlling owners of the tenant and monitored and maintained throughout the life of the guaranteed Lease. Enforcement and collection costs under the Good Guy Guaranty also would be covered, thus taking some of the gaming out of the process.

II. Contrasting the Limited Good Guy Guaranty from the Traditional “Hell or High Water” unlimited payment and performance guaranty – Review of the form of traditional Guaranty of Payment and Performance (Exhibit “A”). Attributes of the traditional unlimited payment and performance guaranty:

1. Guaranty issued by any entity with sufficient credit to guaranty the payment and performance of all terms of the lease. Credit and unconditionality of the document were more important than control of the tenant.
2. Issued as a substitute for cash security deposit as a “bankruptcy proof” benefit to a landlord.
3. Continued irrespective of extension of the lease, renewal of the lease or assignment to unrelated entities of the guarantor. Can have continuing net worth tests.
4. Unconditional, unlimited, always in “stand-by” for payment and performance and the traditional guaranty did not act as a surety or second back stop. Could be drawn on or called upon irrespective of whether the tenant was of “first resort”. The unconditional guaranty could be called upon even if the tenant was not pursued or was protected by bankruptcy.
5. If written properly, the instrument did not depend on validity of the lease and unaffected by tenant defenses and challenges to both the lease and instrument.

III. Significant Terms of the Limited Good Guy Guaranty – While Good Guy Guaranty forms come in all types, shapes and obligations, the significant customary terms are highlighted below:

1. Usually contains (i) a guaranteed period of time or “gap period”, (ii) a limited and specified amount of payment such as fixed rent and possibly additional rentals, and (iii) specified limited specific scope of performance obligations other than payments occurring during holdover. Performance obligations can include insurance of space, maintenance and compliance obligations and redelivery conditions upon removal, to name a few. Almost all Good Guy Guaranty forms include specific indemnity or obligations for reimbursement for and indemnity with respect to the legal and related costs to remove the tenant and regain control of the space as well as enforcement and collection under the Guaranty. The typical “gap period” commences upon default in payment or performance or, more beneficial to a guarantor, after termination of the lease. Some “gap periods” commence retroactively to a period such as 90 days before the default or before the date that the tenant gives notice of its difficulty.
2. Beware of the hidden obligations buried in the definition of the “gap period obligations”:

Examples – a) Obligations defined as rentals “commencing from default and continuing until tenant vacates the space and delivers the premises as required under the lease” (i.e. rent during holdover period and redeliver space and keys and in the condition required at the end of the lease!) The end of the “gap period” may be a long time if tenant technically does not deliver or surrender the keys or does not or can not restore the space to the end of term delivery condition required by the lease. Some redelivery conditions are like the removal of the structural bank vault in one of the Park Avenue buildings.

Months can go by while trying to obtain demolition permits and work contracts. Some redelivery conditions can include costly legal compliance.

– b) Obligations defined as “all financial obligations payable by the tenant which occur during the “gap or guaranty period”. If the tenant holds over and the landlord during the holdover or “gap period” terminates the lease via *condition of limitation*, the tenant could be obligated for all accelerated rentals and damages triggered and accruing by the termination of the lease during the Good Guy Guaranty Period! This is not of course the conventional intended limited guaranty, but clauses are drafted this way to be “crafty”.

3. It is not uncommon for the landlord to also tack on a certain obligation of a guarantor for an initial period of a new lease. For instance the “obligations” can also be for all unamortized brokerage commissions and work allowances or “Landlord’s Work” for initial preparation of the leased space in the event of default or termination of the lease within the first two years of occupancy.

4. Less uniform are the stated conditions to end the obligations of the “gap period”. The simplest end of “gap period” is when the tenant “surrenders” the space. Hidden conditions such as return of keys, redelivery of the space in compliance with laws and in a condition such as demolished or restored to pre alteration condition being dealt with by adding those absolute or certain costs to the rentals calculated for the “gap period” before surrender of the premises. This makes enforcement of the good guy guaranty less difficult since there will be little ability to defend against the additional obligations if they are specified and liquidated at an amount or can be determined without argument over timing and control of the space etc. This is especially true for removal of liens or violations recorded against the space or building which are the result of the tenant.

5. It is not uncommon for the landlord also to require a period of time to be added onto the gap period to allow for “down time” loss of rentals during the “re-marketing” of the space. Such clauses usually add 6 months for instance onto the end of the period after the tenant surrenders the space. The theory here of course is that the space can not with certainty be marketed as “available or deliverable” until the tenant is out. Nothing is more chilling on the marketing of space than for a prospective occupant to know that there is a “holdover” condition.

6. Generally good guy guaranty obligations end at the subleasing or assignment of the lease to a non-related or non-affiliated tenant entity. The assignment and subleasing rights in a lease and in the guaranty can be conditioned on the substitution of a new Limited Good Guy Guaranty or assumption thereof by the controlling parties of the new occupant. Generally good guy guaranty obligations do not end if the lease is extended or renewed. They are not also limited to the original space and should cover additional or option space added. Care and attention needs to be given for the effect of assignments of leases resulting from change in issued shares of a corporate or limited liability company. The intent of the guaranty to incentivize removal of a “holdover”

tenant is defeated if the new controlling shareholder or member is not , as a condition to the change in share ownership or control, required to provide a good guy guaranty.

7. Generally a good guy guaranty can be given by an individual or individuals that control the tenant occupant and certainly can be given by a corporate entity or its majority shareholders or limited liability company or its members. Good guy guaranties can be layered for different amounts, periods or different persons. While it is usually a good idea to make multiple or layered good guy guaranty documents with only one guarantor, I have seen them with multiple guarantors “jointly and severally”. Multiple or layered guaranty documents and their obligations should be coordinated to avoid duplication and for ease of calculation of contributions for recoupment by the guarantors. Some jurisdictions allow defenses to the guarantors for duplicate payments or duplicate or overlapping “gap periods”.

8. Good guy guaranty obligations can be secured by security deposits and as such should be able to avoid issues in the event of bankruptcy of the tenant entity and also be outside the limitation of damages under the bankruptcy code if properly defined in the document.

