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COLORADO REAL ESTATE JOURNAL

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

MAY 5, 2010 – MAY 18, 2010

Guarantees, guarantors in leases: Making sure you get paid

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In more settled times, landlords primarily looked for additional security from those tenants that were newer entities or had smaller balance sheets. Given the large number of Fed actions and bankruptcy filings, however, the paradigm has shifted. Now, absent a large balance sheet and strong, lengthy history, prudent landlords are requiring most tenants to provide additional security for lease obligations. A couple of the more common forms of additional security required by landlords are either a personal guaranty from a principal of the tenant; or a guaranty from the tenant's parent.

■ **Guaranties give landlords additional avenue to pursue payment.** In a lease context, a guaranty is the agreement by a party, not the tenant, to independently guarantee the complete performance of the tenant's lease obligations.

A guaranty typically is styled as a separate agreement between the landlord and the guarantor. Thus, a contractual obligation, based on the terms of the guaranty, to the landlord by the guarantor is created. It is important to make sure that the guaranty is in writing, signed by the guarantor and that the terms are clearly spelled out as guarantees are construed against the obligee. The guarantor is typically related in some way to the tenant, whether as an individual principal or a parent company.

Obviously a major purpose in obtaining a guaranty is to provide the landlord with another avenue to pursue if the tenant defaults under the lease. This is true not only of payment obligations, but also should extend to the tenant's performance obligations.

■ **Bankruptcy damage cap applies to tenants, not guarantors.** It is also important to note that the bankruptcy damage cap does not apply to third-party guarantors that are not in bankruptcy. Thus, if a defaulting tenant files for bankruptcy protection, although the tenant's liability under the lease for future rent would be limited to an amount not to exceed the greater of one year of rent or 15 percent of the remaining rent reserved under the lease (not to exceed an amount equal to three years' rent), the guarantor's liability would not be so limited. However, if the guarantor files for bankruptcy protection, the above cap and limitation would apply.

■ **Lease modification can discharge guarantor from obligations.** Landlords typically have a form guaranty to attach to their lease. What happens to the guaranty when the lease is amended or modified is not always so clear. Is the existing guaranty valid and enforceable against the guarantor following the amendment?

Colorado follows the general rule that states that a modification that is not contemplated by the guarantor can discharge that guarantor from his obligations under the guaranty agreement. However, Colorado also recognizes the exception to that rule in that where the guaranty agreement contains a provision that authorizes changes to the agreement that gives rise to the guaranty agreement (i.e., a "consent-for-modifications" clause), then so long as the modification to that underlying agreement is within the scope of that authorization, the guarantor is not discharged. What constitutes the modification and the scope of authorization generally is a factual inquiry and can be difficult to determine.

Typical guarantees provide consent for modifications clauses. They often state that the landlord and tenant may from time to time compromise, extend or otherwise modify any or all of the terms of the lease without notice to and without affecting the guarantor's liability under the guaranty. Further, typical language states that the guarantor waives the right to consent to these modifications and that, by executing the guaranty, guarantor agrees that any of these modifications will release the guarantor from liability on the obligation.

■ **Guarantor release of liability in lease modification not a foregone conclusion.** Under the backdrop of Colorado law, certain modifications have been held to constitute a change in the scope of the guaranty that falls outside the "consent-for-modifications" clause and thereby released the guarantor of liability since the guarantor did not execute a consent to the modification. A substitution of the premises resulting in a new premises where the original premises does not constitute a portion of the premises in the modified lease agreement has been determined to be a new lease and, consequently, outside of the scope of a modification.

However, when the guarantor, as an officer of the tenant, was centrally involved in the change in premises – in fact, initiated the change in the premises, negotiated the terms of the amendment and signed the amendment – a question was raised as to his intention to consent to the amendment as guarantor and the release of his liability was not a foregone conclusion.

A change in the tenant, such that the guarantor could no longer rely on that party's performance under the lease, is likely to be seen as a new lease and outside the scope of the consent-for-modifications clause in the guaranty. Thus, it stands to reason that extensions of the term and modifications to the lease terms, such as rental rates and tenant finish work, likely would be considered within the scope of a typical consent-for-modification clause, while major changes to the fundamental subject matter of the lease would not.

■ **Landlords should ensure guarantees include modification clauses.** A consent-for-modifications clause encompasses the possibility of significant modifications to the lease for which a guarantor would be liable without executing a further consent. Thus, prudent landlords will want to make sure that their guarantees include these clauses.

However, since the guarantor's exposure is not without limits, the prudent landlord would be well served to address the guaranty when the lease is guaranteed. This can be as simple as a separate acknowledgment from the guarantor, acknowledging and affirming the modifications to the lease, and reaffirming its guaranty obligations.▲