

# GUARANTIES: A PRACTICAL CHECKLIST

## IS IT WORTH THE PAPER ITS PRINTED ON?

By Glen S. Dresser, Esq.

### Typical Scenario

Guaranties are like insurance policies. Most people never read them until there's a problem. You enter into a lease with a corporation, a limited liability company or other business entity, or, with a weak tenant. You want a guaranty to make the deal a more solid financial deal. The documents are sent out for signature and you get them back signed, OR you take over a property and inherit a lease and guaranty negotiated by a prior owner. You believe all is well, until, at some point, your tenant can't pay and you look in the file for the guaranty. Sometimes you find an unpleasant surprise.

### Guaranty Issues

There are a number of things that can potentially go wrong when you are dealing with a guaranty. The three most common issues we see are (i) guarantor identity issues, (ii) drafting issues; and (iii) collection issues.

#### I. Guarantor Identity Issues:

A guaranty is the promise by someone to pay the debt of someone else, but it is amazing how often we hear that the guaranty is a forgery and upon researching it, find out that the allegations are accurate. These allegations are most often an issue when the guaranty was mailed out for signature because no one saw the guarantor sign the document. The defense is more prevalent when there is a husband and wife situation, a guaranty purportedly signed by a family member, or other third party who is not directly involved in running the business.

The easiest way to cut off this defense is to meet with the guarantor in person and require photo identification from the person signing your documents. If the document signature doesn't match the identification signature, it should set off alarm bells. If the guaranty is being signed without you witnessing it and confirming identity, you may also require that the guarantor's signature be notarized. This eliminates any identity

issues.

If you inherit a guaranty from a prior owner, you could send out a letter to the guarantor confirming there is new ownership in place and that you have their guaranty on file. A failure to respond by the guarantor could create a defense to a subsequent forgery claim. If you do not have contact information for the guarantor, you already know there is a potential problem.

There is already a lot to do as a property manager and as a broker, but you definitely may want to go the extra mile when there are substantial dollars involved on a major lease deal.

#### II. Drafting issues:

When you are doing a new lease your guaranty form probably has been reviewed by legal counsel. Nevertheless, issues created by ambiguous drafting continue to come up from time to time. Most frequently, it occurs when there are negotiated in-house revisions to an existing guaranty form for such things as dollar limits or burn off/provisions. These are some things to be taken into consideration:

#### A. Extensions and Renewals of an Existing Lease

The issue of extensions and renewals can come up in a number of ways. The first question is whether the guaranty even states that it covers extensions, renewals and modifications. If it does not, then you need a new guaranty form. Even if the language is present, extensions, renewals and modifications can cross into vague areas. What if the tenant is relocating to a new suite? What if the lease is amended to add additional space? Often a guaranty will define the guaranty as applying to a specific lease agreement on a specific leased space which can create potential ambiguity. Sometimes the guarantor is bargaining for exposure of a specific duration or dollar magnitude. If you are planning to do a lease amendment or renewal and the guaranty is important to the decision, then you should review the guaranty first and address any of the potential issues raised above. It is also very important to get the guarantor to acknowledge the amendment, renewal or extension and consent to it in writing to reaffirm the guaranty.

#### B. Illusory Guaranty

A guaranty is the promise to pay the debt of a third party. It happens sometimes that the named tenant is actually a fictitious business name of an individual. If the individual signs a guaranty, the guaranty is called "illusory" because it is meaningless to promise to pay your own debt a second time.

#### C. Burn off Provisions

On a large lease, the guarantor may bargain for a reduction of liability during the term of the lease. If

you are going to extend, modify or renew the lease, the burn off provision can create potential ambiguity on the guarantor's liability for the modified or extended term. If you intend to reset the liability and burn off period, it should be specifically addressed in writing.

#### D. Cap provisions

Cap provisions are related to burn off/provisions in that they limit the guarantor's liability to a specific maximum dollar amount. The issue here is how payments are to be applied to the maximum dollar limit. For example, if the liability under the lease is \$500,000 and the cap limit is \$250,000, a well drawn guaranty will specify that any money collected from the tenant will be applied "last" to reduce the liability under the guaranty. In other words, if you collect \$250,000 of the \$500,000 from the tenant, the guarantor's liability would still be \$250,000.

#### E. Waivers of statutory defenses

The most important part of a guaranty is the waiver language. The guarantor must waive any and all rights that require you sue the tenant "before" coming after the guarantor. If those waivers are not present then the guaranty is almost worthless. If you inherited an old guaranty, you may want to compare it to your current version and try to get it updated if there is an extension, renewal or modification pending. The current boiler plate language available usually includes things like waivers of statutes of limitation, assignment of rights in bankruptcy and subordination of claims by the guarantor against the tenant.

#### F. Choice of Law Issues/ Out of State Guarantors

Sometimes a guarantor is not a California resident, or it could be an out of state entity. Whenever dealing with an out of state entity, the guaranty should specify that California law applies and that they consent to litigating any issues in California.

#### G. Authorization

If the guarantor is a business entity rather than an individual, there can be a claim that the guaranty was not properly authorized. Good practice is to require a resolution authorizing the guaranty or proof of authority by the signing person to make the guaranty.

#### III. Collection Issues

A guaranty is nice to look at and lovely to hold, but if the guarantor has no money you may as well fold. If the guaranty is just a formality in your leasing decision it may not matter as much, but getting good financial information is critical if you are relying on the guarantor to perform in the event of a default. If you have a guarantor, make sure to obtain sufficient information to allow counsel to (a) find that guarantor; and (b) find his or her assets. A guarantor should fill out an application that includes personal identification such as social, date of birth, name of spouse and home address. The guarantor's assets should also be provided with enough detail to allow counsel to

find them. A financial statement that lists 3.2M in real estate but not specify exactly where the real estate is located is not helpful. Counsel needs to know the address of the real estate in addition to the specific location of any other assets. Details including account numbers, addresses, etc. are critical to any recovery down the line.

By: Glen S. Dresser, Esq.

Any information contained herein is intended for informational purposes only and should not be construed as legal advice. Seek competent counsel for advice on any legal matter.

**Our firm specializes in the representation of commercial real estate owners and managers. We handle lease negotiation and drafting, commercial collection, eviction matters, tenant work-outs, the creditor side of bankruptcy, the defense of mechanics' lien actions, and other work that helps to maximize the value of the real estate. We strive to be diligent, innovative and responsive to our clients' needs. We also offer legal updates and proactive legal seminars to our clients.**

