

The Property Line: The Evolution of the Good Guy Guarantee

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Welcome to The Property Line, a commercial real estate podcast brought to you by Seyfarth Shaw's Real Estate department. The Property Line is a brief discussion of current market trends, bringing you insights from our acclaimed national team of real estate attorneys. Each episode focuses on a key takeaway for the busy real estate professional. Now, on to this week's discussion.

James O'Brien

Hello and welcome back to The Property Line. My name is James O'Brien, and I'm a real estate partner in Seyfarth's Washington, DC office. My cohost is Eric Greenberg, a real estate partner from our Boston office, and we're joined today by Jason Polevoy, a real estate partner in our New York office. Welcome Jason, and thanks for joining us.

Jason Polevoy

Thank you very much for having me.

James O'Brien

Well, it's good to have you here. We're talking about a New York thing, so it's good to have a New Yorker. Jason is here to discuss the Good Guy Guarantee, a mysterious creature of the New York City leasing market, at least mysterious to some of those outside of New York, that is often misunderstood and has started migrating to other markets. I've recently encountered Good Guy Guarantees in both DC and San Francisco. So Jason, can you give us just an overview of what a Good Guy Guarantee is and how it's different, say, than a full lease guarantee?

Jason Polevoy

Sure. Okay, to start out with a full guarantee is obviously it's a guarantor who will guarantee the obligations the tenant under the lease, because maybe payments and performance obligations sometimes limited to payment, but that's what we call a full guarantee. Then there are certain types of limited guarantee. Those could be limited by dollar amount, subject to a cap or other certain limitations. The Good Guy Guarantee, in effect, is a type of limited guarantee. And the original idea behind the Good Guy Guarantee was it was to provide protection, some protection for landlords against hold over risk by tenants at the end of their term or upon an early termination at the lease that there were a default under the lease. The idea being, is that a and this, this takes into account, in New York, the process to evict a tenant can be lengthy and costly, both in terms of out of pocket costs, and also because of the time, the lengthy time it can take to get out of tenant, it lost rent. So the idea was to have, typically an individual, and this really originated with small businesses, where you had an entity that was the tenant under the lease, which may not have had a great deal of financial wherewithal, and where a tenant could hold up with potentially, if it's tenant who doesn't have a financial wherewithal to performance obligation defaults under lease and stays.

James O'Brien

Right, and then the landlord can't get rid of them and re let the space right.

Jason Polevoy

Right. So the idea was, is to have, typically an individual of owner of the business, or an owner of the business who controls the tenant, to incentivize, to make that individual personally liable for the obligations of the tenant under the lease until the tenant hands over vacant possession, surrenders vacant possession of the premises to the landlord. So that was the original, and that should encompass your holdover rent, etc.

James O'Brien

And what, why the name? What does the "good guy" mean?

Jason Polevoy

Well, the Good Guy Guarantee is to set the that the good guy is going to make sure that the tenant hands over possession, being a good guy...

James O'Brien

Acting like a good guy, and giving the space back.

Jason Polevoy

Right, look, the business may have not worked. We all understand that, but we're going to hand make you know we're not going to be bad guys and stay on without paying rent. We'll hold we'll hand over the keys. Now, over time, the Good Guy Guarantee has morphed into more or you've seen additional obligations added onto a Good Guy Guarantee. Notably, is what's called what's referred to as a notice period, which means that the tenant or guarantor is required to provide prior notice, often in the range of six to 12 months, let's say, prior, notice of its intent to surrender the premises, thereby giving the landlord the idea of being giving the landlord the opportunity to find a replacement tenant. And therefore, on the flip side, there's a minimum the guarantor has a minimum obligation to pay rent, you know, to be responsible for the tenants obligations under the lease from that notice period. And sometimes if, depending on how the Good Guy Guarantee is drafted, it'll be a period of time that will tie to either a notice or surrender, or whichever comes first. In addition, you will also often, now often see Good Guy Guarantees provide for a guarantee of the tenant obligation to remove any mechanics wings that would survive, you know this, which would survive the surrender of the space and the cut and the otherwise the cut off of the rent guarantee under the good gun guarantee.

James O'Brien

Gotcha.

Eric Greenberg

Jason, going back to your point about the notice, sort of concept. We've sometimes heard people refer to these guarantees as a good guy right. You know, describe that it allows the tenant to vacate early. I'll just send you that notice. I'll get out of there soon. Do Good Guy Guarantees really act as some kind of early term termination right for the tenant?

Jason Polevoy

It does not, and that's and it's really a misnomer. It's that I've heard the term Good Guy Right on many occasions, or the Good Guy Termination Right. I've heard it often, not always, from lawyers, but you know, it is a term of art that's out there, and it's really a misnomer. The Good Guy Guarantee does not provide the tenant with any early termination. The tenant entity is responsible for all of its obligations under the lease, including damages if the lease is terminated due to a tenant default, including holdover rents, if the tenant holds over all the Good Guy Guarantee does. It's a guarantee that cuts off at a certain point. That cuts off when the conditions are satisfied. Now, as a practical matter, if you have a tenant that does not have financial wherewithal, it's the flip side is, well, the tenant can hand over the keys and not have, you know, people think it doesn't have any further liability, or at least the guarantor is off the hook. It kind of reverses what the kind of the point of the Good Guy Guarantee was, and I can kind of see how that's how people understand it that way. But the fact of the matter is, the tenant is in the same position, regardless of whether there's a Good Guy Guarantee or not. The guarantee is obligated for the rent through the expiration of termination of the lease. If the lease is expired for holdover rents if it holds over for damages in accordance with the terms of the lease at the lease is terminated due to an event of default. Whether the tenant has the financial wherewithal to pay those obligations is a different story.

James O'Brien

Right, so, I mean, it can be tantamount, in a way, to early termination, right? If you if your tenant is effectively judgment proof, and the only deep pocket is the guarantor, and you're providing a method for the guarantor to be relieved of liability or to have limited liability. You're left with a tenant who is still liable but may not have the means to pay for those liabilities. So I guess you could think about it that way. They're not technically released, but the guarantor might be the only one who can afford to pay, and they would be released. So that, I think that's why people think of it that way.

Jason Polevoy

Yes, yes. Just to be clear, it's not a right. It doesn't create a right.

James O'Brien

No, I mean, it sort of describes what happens in a scenario where the tenant is breaking the lease early. So it provides a procedure right where, like if the tenant is breaking the lease early, but has provided the right notice and follow the other steps, then their guarantor liability is limited to the liability during that notice period and any holdover, essentially, right?

Jason Polevoy

Right.

James O'Brien

Got it. But yes, I mean, I've encountered that too, where I've even seen, you know, Good Guy Guarantees being specified in LOIs, and then tenant termination rights coming back in in the tenant's comments. So there's definitely a misconception of it out there, and maybe, and maybe more so in markets outside of New York, where I don't think it is quite as common, even though I have seen it in

other markets. One other complicating factor, I guess, to a Good Guy Guarantee, would be subleases. So if there's a sublease in place, how is, how is that affecting the Good Guy Guarantee? What? What happens? Can the guarantor get released if there's a subtenant who's sitting in the space, even if the tenant has, quote, unquote, surrendered it?

Jason Polevoy

That's actually a very interesting question. And the answer is, you have to look at what the guarantee, the good guy, the language in the guarantee. Typically I would see, I would expect a Good Guy Guarantee to provide that this, that the premises must be surrendered to landlord in accordance with the terms of the lease, or in the condition required by the lease, and it would be a surrender of vacant possession. So a subtenant, if it's subtenants and occupancy, technically, you could not have that that condition, yes, unless the subtenant is there, the obligation to surrender vacant possession to the landlord, it's impossible to satisfy.

James O'Brien

Right. I mean, so I guess basically, if you're a tenant and you want to potentially rely on your guarantor's ability to get off of the guarantee, you've got to be willing to make sure that you can get your sub tenants out as well.

Jason Polevoy

That is correct. Something to consider if one is a Good Guy Guarantor, or representing a Good Guy Guarantor is whether to propose a carve out if the landlord is obligated to recognize the subtenant as its direct tenant.

James O'Brien

Right. So, if there's an NDA, there's an NDA, right? The landlord has said, I recognize this subtenant. If the tenants lease is terminated, you might, as the guarantor, say, like, I should be relieved still, because you're agreeing that that subtenant can be there and I'm not related to them anymore.

Jason Polevoy

Right, but the point is also, though, if the tenant, if the landlord recognizes the sub tenant as its direct tenant, then those, the rents that were paid under that new tenancy by the subtenant presumably would be credited to the obligations of the tenants, of the damages by the tenant.

James O'Brien

So even if you're if you're a guarantor who's not released, actually having a sub-tenant in place is not a bad thing, because that subtenant would be paying the rent that you'd otherwise be liable for.

Jason Polevoy

Potentially. Yeah.

Eric Greenberg

But Jason, let's take a look at a recent case that may impact the Good Guy Guarantee. Last year in New York appeals court affirmatives, the case of 122nd and East 42nd street versus sharp, which a

guarantor was not released from liability under its Good Guy Guarantee, even though the tenants surrendered the premises and the sort of finding was because the landlord had not consented to the surrender. This seems to me kind of a concerning result for guarantors and tenants. Can you describe this holding and how to draft around the issue?

Jason Polevoy

Sure, it was kind of an interesting and somewhat odd case. It may have been in fact based on a certain fact pattern with certain facts relating to this case, but nonetheless, my understanding is that the guarantee at issue incorporate, provided that it incorporated all the terms of the lease and the Good Guy Guarantee and the good guy, and the lease provided that any surrender of the premises would have to be consented to by the landlord in writing, or otherwise accepted by the landlord, and the court found that that did not happen, even though, as a practical matter, it sounded like the landlord did accept it.

James O'Brien

Yeah. I mean, I think there was a set of Good Guy Guarantee conditions that the tenant complied with, including handing back the keys to the landlord. But later, the landlord came back and said, well, you know, the guarantee also incorporated the provision from the lease by reference that said, no surrender is effective without my consent. And you know what? And you know, you handed me the keys, but I didn't actually consent to the surrender, even though there's a Good Guy Guarantee with procedure specified, and the courts agreed and found that, you know, the tenant and the guarantor continued to owe hundreds of thousands of dollars of more rent.

Jason Polevoy

Right, and to be clear, this case is subject to appeal with the New York Court of Appeals, which is the highest court in New York, so it's not finally settled, but this case is that out there. To Eric's point in terms of drafting, yes, if you're representing a guarantor, it is important to read what the conditions are to trigger the release of the guarantors obligations under the guarantee. As the language should be read critically. Are there any holes in it? What it should provide is that the requirement is that the tenants surrender the premises to the landlord. Typically, you know, in accordance, you know, in the condition required by the lease. And to make sure, look, I don't typically see guarantees that incorporate all the terms of the lease, but obviously, there are some out there. Be very careful and be on the lookout for that. And to provide that the conditions to the release are set forth in the guarantee and solely governed by the guarantee, except to the extent that you're referencing vacant possession, and the condition required by, you could say by the lease or reference the section of the lease, to be as specific as possible.

James O'Brien

Right? Yeah, I think you want to either not incorporate, by reference, all the terms of the lease, which you, if you're the guarantor's counsel, you might want to strike, or, barring that, make sure that the release conditions override any kind of contrary provision in the lease. And that seems to be the mistake that the guarantor and tenant made here, but it was certainly an unintended consequence. I don't know if there were bad facts in the case that led to of the court seeking this result, but as you say, this is a case that's under appeal, so we'll see. But I do think it caused people a bit of concern in New

York, especially since it seemed like the guarantor was remaining on the hook when it otherwise should not have, based on the conditions. But maybe we'll have a whole podcast about that, because we're at the end of our time here, and we're going to wrap it up. But Jason, thanks for joining us today and for giving us your insights and the overview of the Good Guy Guarantee and a special thanks to our listeners for tuning in. Please keep an eye out for future episodes and until then, be well.

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