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Ensuring the enforceability of a guaranty after the breach of the underlying lease - by Noble Allen

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Consider this not too unfamiliar scenario in the age of COVID-19: Five years ago B.C. (Before COVID), the tenant, a limited liability company, signed a 10-year lease. By all accounts, both parties to the lease not only expected the tenant to crush it through the initial term, but they also fully expected the tenant to at least exercise the first of its two five-year extension options. That was five years ago. Then COVID-19 hit. The tenant tried to make a go of it, but was soon overwhelmed by state-mandated closures, lockdowns, and restrictions that completely decimated its business. This tenant could have been a restaurant, a gym, or a high-end fashion boutique on Main Street. Sadly, the tenant was forced to shutter because it was in no position to pay its rent, its employees, or its vendors.

It turned out that the lease was secured by a personal guaranty. Long before the lease was executed, the landlord had performed its own due diligence on the financial strength of the guarantor, who had enough financial liquidity to guaranty the performance of the tenant's rental obligations were the tenant to go into default. As a result, the landlord was not quite as concerned about the financial health of the start-up LLC tenant. So once the tenant failed to make its rental payments for the sixth consecutive month, the landlord notified the guarantor of the tenant's default and provided the guarantor with the necessary grace period to cure the default. The guarantor did not timely cure the tenant's default. Now the landlord wishes to enforce the guaranty and pursue the guarantor for the tenant's breach of the remaining five years of the lease term (and no, this was not a "good guy" or "good gal" guaranty).

How can the landlord ensure the enforceability of the guaranty and what are some potential roadblocks?

In certain situations (and for a variety of reasons), the landlord and tenant may have entered into a lease amendment or a lease extension long before the initial 10-year term was to have expired. In some jurisdictions, if the original guarantor was not a party to the amended lease or the lease extension, and if he did not sign a reaffirmation of his guaranty when that amendment or extension was entered into, then the legal concept of "novation" may nullify the guarantor's initial obligations to guarantee the tenant's performance, and the landlord may be left without any recourse against the guarantor. A novation is the substitution of a new contract for the one that was in place. An essential element of novation is the extinguishment of the original contract (i.e., the initial lease with the guaranty) and the substitution of a new one (i.e., the lease amendment or the lease extension) sans the original guarantor.

In other jurisdictions, the concept of a "continuing guaranty" may (but not always) save the day for the landlord even if the lease had been extended, renewed, or even amended, without the reaffirmation of the original guarantor. This legal concept essentially stands for the proposition that regardless of the consent of the original guarantor to the subsequent lease transaction, because the original guaranty contained a clear and unambiguous provision stating that the guaranty is a "continuing guaranty," the guarantor will remain obligated to the landlord even without a reaffirmation of the original guaranty.

Unfortunately, depending on the jurisdiction, the enforceability of a continuing guaranty provision is not always foolproof and may not always redound to the landlord's benefit. Some courts will impose liability on the guarantor "only for such a period of time as is reasonable in light of all the circumstances of the particular case." Translation: this rule will not be applied uniformly; rather, it will be adjudicated by courts on a case-by-case basis depending on the facts of the case and based on factors that may not necessarily favor the landlord. Further, some courts will simply not allow the tentacles of the continuing guaranty provision to extend beyond the original term of the underlying lease, regardless of "continuing guaranty" provision.

So while it is impossible to expect landlords always to obtain foolproof guaranties to secure their tenant leases, the past few months have clearly demonstrated why it must be an essential component of a lease transaction, particularly with tenants that lack the requisite financial strength or track record to withstand a rough and tumble economy. However, once a solid guaranty is in place, landlords need to take prudent actions to ensure that the guarantor's obligation remains intact and is not invalidated or rendered void because a reaffirmation of guaranty was not secured during every lease transaction or because the landlord relied a bit too heavily on the sometimes amorphous concept of a continuing guaranty.

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