

Real Estate Trends

REAL ESTATE TRANSACTIONS

Good Guy Guarantees: How One Word May Effect Guarantors

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In December 2022, the First Department issued a decision that caught the leasing world off guard as it relates to so-called “Good Guy” guarantees. In *122 East 42nd Street LLC v. Joseph Scharf and Sarah Gotlib*, App. Div. Case No. 2022-04777, the court unanimously affirmed a Supreme Court decision which held that the personal liability of individual guarantors—under what the parties’ thought was a classic “Good Guy” Guaranty—could not be extinguished unless the tenant, prior to its surrender of the premises, obtained landlord’s written consent. That holding, now on appeal to the New York Court of Appeals, is being watched closely by industry practitioners concerned that, if affirmed, it may convert existing good guy guarantees into unconditional guarantees.

Background

In New York, a “Good Guy” guaranty is a ubiquitous concept utilized in many commercial

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leases. Typically, tenants in complex commercial leases are corporate or special purpose entities. To enhance the credit supporting the lease and to ensure performance by the tenant, landlords often insist on a personal guaranty. In the first instance, a landlord may ask the tenant for a full, unconditional personal guaranty (often to be issued by the principal of the tenant) of the tenant’s payment and performance under the lease, but if the tenant balks, the parties often settle on utilizing a Good Guy (personal) Guaranty.

The distinction between an unconditional guaranty and a Good Guy Guaranty is that in a Good Guy Guaranty, the liability of the individual guarantor is terminated if the underlying

tenant complies with certain contractually negotiated pre-conditions—typically, the issuance of prescribed advanced-written notice of the tenant’s intent to vacate, the payment of all rent due through the date of vacatur, the return of keys, and actual broom-clean vacatur. The purpose of this tool is to incentivize the tenant to act like a “good guy” before it permanently vacates and delivers the premises to landlord—often before the term ends. If all conditions are met, the individual guarantor will be relieved of all future liability. Critical to the essence of the Good Guy Guaranty is the tenant’s unilateral ability to comply with the pre-conditions and thereby relieve the guarantor of personal liability.

In *122 East 42nd Street LLC*, it is clear that the tenant and its principals thought they had a

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classic good-guy guarantee on their hands—or so it seemed. To terminate the guaranty at issue, the guarantors were obligated to ensure payment of all rent due to landlord “up to the date on which Tenant...shall return the keys to the premises to landlord and shall quit and surrender to landlord the premises...and otherwise in compliance with the provisions of Article 3 and Article 22 of the lease.” Articles 3 and 22 dealt with tenant’s alterations to the premises and the condition of the premises at the time of vacatur. It is undisputed that the tenant paid all rent due through the date it vacated the premises and surrendered the keys to landlord, and further that it complied with the requirements of Articles 3 and 22.

Nonetheless, three months later, landlord sued the two individual guarantors to enforce the guaranty, filing a CPLR 3213 motion for summary judgment in lieu of complaint. To support its argument that the guarantors remained liable, landlord relied on language in the guaranty’s “whereas” clauses that the entirety of the underlying lease is incorporated into the guaranty by reference. Landlord specifically pointed out that the underlying lease, a standard Real Estate Board of New York form lease, includes, in Article 25 thereof, a “no waiver” provision stating no acceptance of the tenant’s surrender of the premises shall be deemed valid unless in writing signed by the landlord—which written consent had not been obtained.

Adopting landlord’s arguments, the Supreme Court held that the tenant needed to secure landlord’s prior written consent to surrender the premises in order to extinguish the liability of the individual guarantors. The court reasoned that because the Agreement of Guaranty incorporated the entirety of the lease into the Guaranty—and because the lease required landlord’s written consent to any surrender—the liability of the individual guarantors continues absent such written consent.

This resulted in a seven-figure judgment against the individual guarantors, with two actions commenced thereafter; the first seeking all rent due for the calendar year 2021-2022 and the second seeking all rent due for the period 2023 through 2032—potentially \$40 million in personal liability. The guarantors appealed, and in December 2022 the First Department unanimously affirmed. In May 2023, the guarantors successfully moved for leave to appeal to the Court of Appeals, and

the appeal is fully submitted with an argument date to be scheduled.

Arguments Advanced by the Guarantors

Before the Court of Appeals, the parties set forth the following arguments:

First, the guarantors argue that because the guaranty, as written, specified the precise lease provisions requiring tenant's compliance (which guarantors claim tenant complied with), and does not otherwise implicate Article 25 (the aforementioned "no waiver" clause which contains the requirement of obtaining landlord written consent to surrender), the tenant entity was not required to obtain landlord's prior written consent in order to permanently surrender the premises.

Second, the guarantors argue that the surrender obligations prescribed in Article 25 of the lease lie with the tenant entity, not the individual guarantors. As such, the individual guarantors claim they cannot be bound by a contractual provision contained in an agreement to which they are not a party.

Third, the guarantors argue that because the word "surrender" is not defined in the guaranty, it cannot have the meaning ascribed to the word "surrender" in Article 25 of the lease. The guarantors' claim that if the parties meant for the word "surrender" to have the same meaning in both agreements, the agreements would have specifically said so. As such, the omission of a definition of the word "surrender" was intentional, and the legal meaning of the word in each contract is different—in essence, because the guaranty simply required tenant to "surrender," no additional obligations can or should be imposed. Relying on basic contractual interpretation principles that "guarantee[s] are to

be interpreted in their strictest manner," the guarantors argue that the lower court and the First Department unreasonably interpreted the guaranty too broadly. *White Rose Food v. Saleh*, 99 N.Y.2d 589, 591 (2003); accord *PRG Assocs. Ltd. P'ship v. Planet Organic Holding Corp.*, 188 A.D.3d 740, 741 (2d Dep't 2020).

Last, the guarantors also claim that if the decision rendered by the First Department is upheld, thousands of guarantees with similar language across the State could be transformed into unconditional guarantees, leading to the financial ruin of many small business owners State-wide.

Landlord's Counter-Arguments

In opposition, landlord argues that, in addition to all other conditions precedent to extinguish the liability of the individual guarantors, tenant was required to "quit and surrender" the premises to landlord. Adopting the Supreme Court's reasoning, landlord argued that because the guaranty incorporated the entirety of the lease, the guarantors are bound by the surrender obligations as set forth in the lease. Tenant may only surrender the premises pursuant to the agreement to which it was a party—the lease—which, pursuant to lease Article 25, required tenant to obtain landlord's prior written consent to its surrender. Because landlord did not (and does not) consent to tenant's surrender in 2021, landlord claims the guarantors remain liable for all of tenant's ongoing monetary obligations through the expiration date of the lease in 2032.

Landlord further argues that the parties to this transaction were sophisticated business parties, with sophisticated real estate counsel, who agreed to the incorporation of the entirety of the lease into the guaranty, where the lease

specifically states that landlord's written consent is required in order to surrender. Had the parties meant for tenant to be permitted to simply vacate without obtaining landlord's consent, the documents would have been drafted that way. Here, because the guaranty requires tenant to "vacate and surrender," and the guaranty incorporates the lease in its entirety, tenant must surrender as required by the lease.

Second, landlord claims that because the lease and the guaranty were executed contemporaneously by the same parties as part of the same transaction, the two contracts need to be read harmoniously. Here, landlord claims that the incorporation of the lease into the guaranty did not create an additional right upon the guarantors, it simply reflected the fact that the two contracts contain interrelated obligations and must be read as one. Here, landlord argues that the contractual provisions are actually harmonious, as the word "surrender" is not defined in either document, and the guaranty specifically incorporated the lease in its entirety. As such, any premature surrender by tenant must be conducted pursuant to the requirements set forth in the lease.

In response to guarantors' public policy argument, landlord argues that this issue can be appropriately dealt with at the drafting stage. If a prospective guarantor is concerned by the First Department's holding, they can insist that the guaranty be drafted to specifically define what it means for the tenant to complete a valid surrender, including that landlord's prior written consent is unnecessary. Put plainly, landlord argues that guarantees vary from lease to lease, are always open to negotiation prior to execution, and this ruling will not cause the upheaval the guarantors claim.

The Takeaway

This case is an emphatic reminder that words matter, and overreliance on past precedent is not good practice. If the First Department decision is affirmed, existing good guy guarantees with similar wording may be transformed into unconditional guarantees. Real estate professionals should review all existing guarantees to understand additional risks resulting from this holding and consult counsel to consider any other appropriate actions to take to address current guarantees and prospective negotiations.