

Implications of the good guy guaranty decision - by Thomas Kearns



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New York's highest court ruled last year that if a so-called good guy guaranty conflicts with the lease it guarantees, the terms of the guaranty will prevail. In *1995 CAM LLC v West Side Advisors, LLC*, the guaranty included a sentence in which the terms of the lease were expressly incorporated into the guaranty. The lease itself prohibited a surrender without the landlord's consent. An apparently very creative landlord's counsel won decisions at the trial court and intermediate appellate court saying that since the tenant was prohibited from surrendering in the lease itself, the guarantor

could not limit its liability by surrendering as provided in the guaranty which was clearly not what the guarantor anticipated. (In a good guy guaranty the guarantor promises to pay the rent for the commercial space through the date that the space is surrendered peaceably to the landlord.)

The decision should not be a surprise, but it has other implications. While the guarantor's liability is clearly capped by the surrender, the liability of the entity that is the tenant is not. The tenant's liability is governed by the terms of the lease. New York is famous for not requiring commercial landlords to mitigate damages. However, suing to collect damages from a defaulting tenant is not easy. There are several common variants of the damage clause in the typical commercial lease for tenants but one common one provides for the acceleration of all rents due for the balance of the term based on a present value discount. Another New York court ruling, *172 Van Duzer Realty Corp. v. Globe Alumni Student Assistance Ass'n.*,

New York provides that a rent acceleration clause can be unenforceable if it qualifies as a penalty and not a fair estimate of landlord's damages. One way to make sure the lease damage clause is not held to be a penalty is to credit the tenant the then current fair rental value of the space. But how should landlords calculate that rental value? Most lease clauses do not provide for an arbitration of that amount leaving the landlord in the precarious position of needing a trial to determine the exact credit.

Another alternative for a landlord is to merely pursue actual damages as the months remaining in the lease term tick off. But that process will increase legal fees and risk delays and gives the tenant defendant opportunities to point to inequitable conduct that might sway a judge. So what is a smart landlord to do? The author's proposal is to build into the lease a reference to the surrender permitted under the good guy guaranty. By having an express cross reference, the landlord avoids a creative tenant's lawyer from trying to

convince a trial level court that the 1995 CAM decision means that the tenant has the right to surrender without being liable for damages. The next question is how to calculate the damages owed by the tenant due to the tenant's surrender. First, make sure your rent acceleration clause is not a penalty by including a meaningful present value discount and an offset for the then rental value. Since avoiding a trial on the determination of fair market value should be a consideration, consider a baseball type arbitration where an arbitrator picks either side's estimate of the remaining rental value that is to be credited to the tenant's damages amount.

Given New York case law, landlords should proceed carefully in integrating the good guy guaranty with the lease itself and the commercial real estate bar should consider updating longstanding damage clauses to make the result fairer and more efficient.

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