

COMMERCIAL TENANT'S LEASE INSIDER®

NEGOTIATING, DRAFTING, & LIVING WITH YOUR LEASE

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Get Right to Replace Guarantor if You Assign Lease

To get a lease, you may have to agree to give the owner a guaranty signed by one of your officers, directors, or owners—or by your parent company. These parties are related to you and have a vested interest in seeing that you sign the lease, so they should be willing to give you this financial backing. But that could change if you later decide to assign your lease to an assignee that's not an "affiliate" of yours (that is, a company that you don't control and that doesn't control you). If your guarantor has no relation to the assignee, it probably won't want to give the assignee any financial backing. So you'll want to replace your guarantor with a new guarantor supplied by the assignee.

But if your lease is like many we've seen, it may have this loophole: If an assignment occurs, the lease doesn't give you the right to replace your guarantor with another guarantor—even one supplied by the assignee. The result: Your guarantor is stuck guaranteeing a lease for an assignee with which it has no business connection.

To plug this loophole, get the right to replace your guarantor when you assign a lease, says New York City attorney Jonathan Weiss. We'll tell you what points to cover in your lease clause to give you this replacement right and how to negotiate three protections that an owner will typically demand. And we'll give you a Model Lease Clause, at right, that you can adapt and use in your lease that includes those points and negotiated protections.

What Replacement Right Clause Should Say

Make sure that your replacement right clause, like our Model Lease Clause, says the following:

- You've got the right to provide the owner with a replacement guarantor if you assign your lease;
- The replacement guarantor's responsibilities will begin on the date that the assignment goes into effect; and
- The original guarantor will be released from all liability once the assignment goes into effect, says Weiss [Clause, pars. a, c].

How to Negotiate Three Potential Owner Demands

An owner probably won't give you a guarantor replacement right unless you agree to give the owner certain protections, notes Weiss. It's reasonable to give the owner some protections, as long as they don't undermine your replacement right. Here are three protections that an owner will typically demand, and suggested compromises:

Protection #1: Replacement guarantor must have high net worth.

➤ *Owner's view.* Expect the owner to demand that any replacement guarantor have a high net worth, says Weiss. Otherwise, it won't have the assurance it needs that the replacement guarantor will be financially secure enough to fulfill its obligations.

➤ *Your view.* You'll want to set the replacement guarantor's required minimum net worth as low as possible so that the assignee can easily find a guarantor who qualifies.

➤ *Compromise.* Say in the lease that the replacement guarantor's net worth must be not less than a set

dollar amount equal to the original guarantor's current net worth, advises Weiss [Clause, par. a]. This way, the owner will be no worse off than before.

Protection #2: Replacement guaranty fully protects owner.

➤ *Owner's view.* The owner will want to make sure it's fully protected by the replacement guaranty. So it may seize the opportunity to get more protections than it had in the original guaranty.

➤ *Your view.* You'll want the replacement guaranty to be identical to the original guaranty, since the owner should be no better off than before and the assignee may have a harder time finding a replacement guarantor who will be willing to agree to a more demanding guaranty.

➤ *Compromise.* Agree that the replacement guaranty will be "substantially similar" to the original guaranty, suggests Weiss [Clause, par. b]. That gives the owner a little wiggle room to seek some additional protections, but not a lot—since it means that the replacement guaranty will be basically the same as the original guaranty, he explains.

Protection #3: Your guarantor isn't released.

➤ *Owner's view.* The owner will want to keep your guarantor on the hook, along with the replacement guarantor, after the assignment. This way, if the replacement guarantor turns out to be a deadbeat, it can go after your guarantor.

➤ *Your view.* You want your guarantor to be released from all liability once you assign the lease.

➤ *Compromise.* In this situation, the owner's demand is unreasonable. To respond to the owner's concerns, you can offer this compromise, suggests Weiss: Agree that your guarantor will continue to remain on the hook for all obligations arising up to the time that the replacement guaranty is delivered to the

MODEL LEASE CLAUSE

Change Guarantors When Your Assignee Is Unaffiliated Third Party

The following clause was drafted by New York City attorney Jonathan Weiss. Put it in your lease if you're required to give an owner a guaranty.

Paragraph a gives you the right to provide a replacement guarantor if you assign your lease to an unaffiliated third party. Paragraph b requires the replacement guaranty

to be substantially similar to the original guaranty. Paragraph c says that your guarantor will be released from liability when the signed replacement guaranty is delivered to the owner. (You'll need to define "Affiliate" elsewhere in the lease.)

Show this clause to your attorney before putting it into your lease.

REPLACEMENT GUARANTOR

- a. Replacement Guarantor.** In connection with any proposed assignment of Tenant's interest in this Lease to any person or entity which is not an Affiliate of Tenant, Tenant shall have the right to provide Landlord with a replacement guarantor (a "Replacement Guarantor") of all of Tenant's obligations hereunder effective from and after the effective date of such assignment (the "Assignment Effective Date"), provided that the Replacement Guarantor has a net worth as of the Assignment Effective Date of no less than \$[insert amount of prior guarantor's current net worth].
- b. Replacement Guaranty.** In the event that Tenant provides the Replacement Guarantor in accordance with this Clause, the Replacement Guarantor shall execute and deliver to Landlord on or before the Assignment Effective Date a guaranty (a "Replacement Guaranty") substantially similar to the Guaranty attached hereto as Exhibit [insert #].
- c. Guarantor's Release.** Upon delivery of the Replacement Guaranty to Landlord, Guarantor shall be released and discharged from all liability with respect to any obligations of Tenant hereunder arising or accruing from and after the Assignment Effective Date, but Guarantor shall continue to remain liable pursuant to the terms of the Guaranty for all obligations of Tenant hereunder which arose or accrued prior to the Assignment Effective Date.

owner. The replacement guarantor, not your guarantor, will be responsible for obligations arising after the owner gets the replacement guaranty [Clause, par. c].

This eliminates any lapse in guaranty protection. For example, suppose the space was contaminated by hazardous materials before you assigned the lease, but the contamination wasn't discovered until after the owner got the replacement guaranty. With this compromise, your guarantor will still be liable for damages resulting from that contamination, Weiss explains. ■

INSIDER SOURCE

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