

## Get Guaranty When Renting Space to Limited Liability Entity

**Y**ou face special challenges when the tenant you're renting space to is organized as some kind of limited liability entity—such as a professional corporation, professional limited liability partnership, or professional limited liability company. With this kind of entity, the liability of the tenant's shareholders, partners, or members is limited by law. Law firms, accounting firms, and other professional firms are often organized as a limited liability entity.

Because this type of entity typically distributes most of its earnings to its shareholders, partners, and members, it may have few assets. And you could end up with little or nothing if you must sue it. And while the tenant's shareholders, partners, or members may have very deep pockets, you ordinarily won't be able to get to them. So it's crucial to make the tenant's shareholders, partners, or members responsible for the tenant's lease obligations—including rent, advises Santa Monica attorney Susan Fowler McNally. To do this, add a clause to the lease requiring the shareholders, partners, or members to sign a lease guaranty that clearly sets out their responsibilities. By signing the guaranty, they give up many of their limited liability protections with respect to the lease.

We'll give you six requirements to include in your lease clause to help you get valid guaranties from the limited liability tenant's shareholders, partners, or members. You can find these protections in the Model Lease Clause: Require All Tenant's Owners to Sign Guaranty. We'll also tell you how to negotiate certain modifications to the guaranty that the tenant may demand.

### Six Requirements to Include in Lease

Make sure that your lease clause, like our Model Lease Clause, includes the following six requirements:

**Shareholders, partners, or members must sign guaranty.** Have the lease require the current shareholders, partners, or members to sign the guaranty, says McNally. And require all future shareholders, partners, or members to sign the guaranty soon—say, within 60 days—after they become a shareholder, partner, or member, she advises [Clause, par.a]. While our Model Lease Clause sets this requirement for all shareholders, partners, or members, you may decide to limit it to those who have a significant net worth.

**Guaranty must be prescribed form.** Attach to the lease as an exhibit the form of guaranty you want the tenant's shareholders, partners, or members to sign. And require the tenant to give you a guaranty in that form, says McNally [Clause, par.a]. Doing this saves you from having to repeat in the body of the lease all of the terms you want in the guaranty. And the tenant can't later claim that it didn't know what the guaranty would say, McNally points out.

**Guaranty must include three key terms.** Even though you're attaching the guaranty form as an exhibit, it's smart to still set out three key guaranty terms in the lease. You want to prevent a tenant from arguing that it wasn't aware of these key required terms:

» *You can go after guarantor first.* You want to be able to demand that any guarantor pay the rent or other amounts

you're owed as soon as the tenant misses a payment, rather than have to chase down the tenant. But you can't go after the guarantor first if you have only a "guaranty of collection." In that case, you must sue the tenant, win, and unsuccessfully try to collect from it before you can go after its guarantors. The process could be costly and lengthy. If you instead get "a guaranty of payment (not of collection)," says McNally, you don't have to go after the tenant first to get paid. You can go first to the guarantors [Clause, par.a].

» *Guaranty must be of payment and performance.* Make it clear that each guarantor must guarantee the payment and performance of the tenant's lease obligations—not one or the other, advises McNally [Clause, par.a]. You want the guarantors to be responsible both for paying you any overdue rent and for performing any obligation (such as repair work) that the tenant failed to do.

» *Guarantors must be jointly and severally liable.* If a tenant is in such serious trouble that it can't pay its rent, it's unlikely to be a productive target for a lawsuit. You'll want to target the guarantors—but you may not want to waste time suing guarantors who won't have enough assets to pay a judgment, notes

*Continued.*



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## Limited Liability Entity *continued*

McNally. Consider getting a clear right to sue any guarantor individually (so you can go after a guarantor with significant net worth) or jointly with other guarantors for any amount up to the total the tenant owes, provided that you don't collect more than the tenant's total debt. If the lease says the guarantors' liability is "joint and several," you've got that right [Clause, par. b].

**Signed guaranty must be delivered with lease.** Don't let the tenant delay in giving you the signed guaranty. Require that it be delivered to you when the tenant signs the lease, says McNally [Clause, par. a].

**Tenant must give you shareholder, partner, or member list.** Require the tenant to also give you a list of its shareholders, partners, and members when it signs the lease, says McNally. And the tenant should give you updated lists after the end of each calendar year [Clause, par. c]. Check that all listed individuals have signed the guaranty.

**Tenant stays on the hook.** Make clear in the lease that you'll always have the right to collect from the tenant the full amount of rent and other money the tenant owes, says McNally. That should be the case even if the tenant dissolves, liquidates, reforms, or reorganizes, she adds [Clause, par. d]. Otherwise, the tenant might try to argue that if you go after the overdue rent from its guarantors, you've released the tenant from paying rent.

### Possible Tenant Modifications:

If the tenant is a law firm or accounting firm, it's likely to be a very sophisticated negotiator. So expect it to request that you make the following modifications to the guaranty clause in the lease—and to the guaranty itself—in an attempt to reduce its guarantors' liability as much as possible:

**Guaranty of payment only.** The tenant may object to having its guarantors guarantee the performance of all of its lease obligations and want to have them guaranty only rent payment. Try not to give into this objection, but you may have to if the tenant has a lot of negotiating power.

**No joint and several liability.** The guarantors may balk at joint and several

liability. An individual guarantor doesn't want to be responsible for all the rent that might ultimately be payable under a lease—especially if the amount is large. Instead, the tenant may insist that you:

» **Cap total liability.** This cap would protect the guarantors from having to come up with unlimited amount of money. For example, the lease might say that the guarantors won't be personally liable for more than an amount equal to the total amount of base rent due over the lease term. But at a minimum, make sure that you calculate the cap to cover your out-of-pocket expenses, such as: rent concessions, tenant improvements, brokerage commissions, and attorney's fees.

» **Cap amount each guarantor must pay.** Besides getting a cap on the total that you can collect from the guarantors, the tenant may want to limit how much of the capped amount each of them may have to pay, notes McNally. That amount is typically based on the percentage that each guarantor owns in the tenant, plus a cushion, she says. If you agree to this cap, require the tenant to give you a list of each guarantor's percentage interest in the tenant, certified as correct by the tenant's chief financial officer. And if the tenant demands that you promise to keep those percentage interests confidential, make an exception for any disclosure necessary to enforce your lease or guaranty rights or if a judicial proceeding or government order requires it.

» **Burn off liability over time.** The tenant might also insist that the cap amounts decrease as the amount you're in danger of losing decreases. If you're forced to agree, bar any decrease at any time the tenant is in monetary default under the lease, advises McNally.

**You'll release guarantors in certain events.** A tenant may want you to agree to release its guarantors from liability under the guaranty if certain events occur. For instance, the tenant may demand automatic release from liability for a guarantor if the guarantor:

### PRACTICAL POINTER:

If you agree to any caps, make sure they don't apply to certain costs, says McNally. For instance, exclude from the cap the costs of hazardous waste cleanup that the lease makes the tenant's responsibility, she recommends. These costs are likely to be very high and the tenant has more control over them than you do, she says. Also exclude your legal fees for trying to collect rent owed by the tenant, since a tenant can force huge legal expenses on you while spending relatively little itself. This is especially true if the tenant is a law firm, because the firm may represent itself in a dispute with you, while you must pay an attorney, she notes. Also exclude late charges and interest.

» **Dies.** A tenant will argue that a dead guarantor's estate shouldn't remain liable under the guaranty. If you agree to release a guarantor's estate from liability, require the tenant to give you written notice of the guarantor's death, says McNally. The death notice must include a certified copy of the filed death certificate proving the date of death.

» **Becomes disabled.** The tenant may also demand that a guarantor who becomes "disabled" shouldn't remain liable under the guaranty. You and the tenant will need to define "disabled." For example, suppose you're negotiating a lease with a law firm tenant that's a professional limited liability partnership. You might agree that a guarantor who's a partner becomes disabled if, for a long time period—for example, at least 24 consecutive months—he can't practice law in substantially the same manner as he used to because of a physical injury, disease, or mental illness, says McNally.

Make sure that the lease requires the tenant to give you written notice of a guarantor's disability that includes enough proof to substantiate the disability, such as medical records and written opinions of the guarantor's attending physicians,

says McNally. Get the right to review and challenge the claim that a guarantor is disabled. And force the guarantor to take an examination by your medical experts to prove whether he's indeed disabled. Also, make sure that if a disabled guarantor is no longer disabled and starts practicing law again as he used to before the disability, you've got the right to make him liable again under the guaranty.

» *Resigns.* A tenant may also demand that you agree to release from liability a guarantor who retires from or is forced out of the tenant. If you agree, make sure that you get certain protections, says McNally. For instance, you may want to require the tenant to keep a set number of remaining shareholders, partners, or members, with a minimum net worth, liable under the guaranty, she says. And make sure that no release of a guarantor who resigns will not be effective unless you get a written notice of the resignation.

### CLLI Source

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## MODEL LEASE CLAUSE

### Require All Tenant's Owners to Sign Guaranty

The following lease clause was drafted with the help of Santa Monica attorney Susan Fowler McNally. Use it if you sign a lease with a tenant that's a limited liability entity.

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

#### GUARANTY

- a. **Guaranty.** Concurrently with the execution and delivery of this Lease by Tenant, Tenant shall deliver to Landlord a guaranty of payment (not of collection) and performance (the "**Guaranty**") executed by each of the current, individual, constituent [*shareholders/partners/members*] of Tenant, including the individual [*shareholders/partners/members*] of any professional [*corporation/partnership/limited liability company*] that is a [*shareholder/partner/member*] of Tenant. The Guaranty shall be in the form attached hereto as Exhibit [*insert#*]. Each new or additional individual, [*shareholder/partner/member*] of Tenant (including the individual [*shareholders/partners/members*] of any professional [*corporation/partnership/limited liability company*] that becomes a [*shareholder/partner/member*] of Tenant) or, after conversion of Tenant into a professional [*corporation/partnership/limited liability company*], each new or additional individual, shareholder, partner, or member of such entity who has an equity interest in Tenant shall execute, acknowledge and deliver to Landlord the Guaranty within [*insert #, e.g., sixty (60)*] days after their admission as a shareholder, partner or member of Tenant. (Each of the current, new, and additional individual, constituent shareholders, partners, and members of Tenant who has an equity interest in Tenant shall be referred to hereinafter as "*Shareholder/Partner/Member*.")
- b. **Individual [*Shareholder/Partner/Member*] Liability.** The liability of each [*Shareholder/Partner/Member*] to pay rent and perform all other obligations under this Lease shall be deemed to be joint and several, individually and as a [*Shareholder/Partner/Member*].
- c. **[*Shareholder/Partner/Member*] List and Replacement Guaranty.** Tenant hereby agrees to provide to Landlord on or before Tenant's execution and delivery of this Lease, and within [*insert #, e.g., sixty (60)*] days after the expiration of each calendar year within the Term thereafter, a list of the [*Shareholders/Partners/Members*]. Tenant shall have the right at the end of such [*insert#, e.g., sixty (60)*]-day period and within [*insert#, e.g., sixty (60)*] days after the deletion of addition of one or more [*Shareholders/Partners/Members*] to provide Landlord a fully executed replacement guaranty meeting all the requirements of this Clause ("**Replacement Guaranty**") and within [*insert#, e.g., five (5)*] business days of receipt by Landlord of such Replacement Guaranty, Landlord shall return to Tenant the prior Guaranty (or when appropriate the prior Replacement Guaranty).
- d. **Tenant's Liability.** Without limiting any rights otherwise afforded Landlord, Tenant shall remain liable to the extent of all of its property and assets for any rent and other sums or damages payable by Tenant under this Lease, notwithstanding any dissolution, liquidation, reformation, or other reorganization of Tenant.