

# CREDIT ENHANCEMENTS IN COMMERCIAL LEASES

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EXHIBITS

<b>Exhibit A</b>	-	<b>Drafting Tips – Lease Inserts</b>
<b>Exhibit B</b>	-	<b>Sample Form of Lease Guaranty</b>
<b>Exhibit C</b>	-	<b>Sample Form of Letter of Credit</b>
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<b>Exhibit E</b>	-	<b>Landlord's Lien</b>

## CREDIT ENHANCEMENTS IN COMMERCIAL LEASES

### I. Introduction.

It has often been said that the lifeblood of commercial real estate is the lease agreement. This statement is true in that it is generally the lease that produces the revenue for an income producing property. Landlords should therefore be quite concerned not only with the content of the lease document itself, but also with the credit of the tenant signing the lease. This statement has never been more true than now, given the influx of new undercapitalized tenants into the commercial real estate market as a result of the so-called "new economy." While the growth potential for these tenants makes them potentially attractive to landlords, their high financial volatility also makes them an extremely risky proposition. In light of this new environment, it seems prudent that landlords re-examine traditional credit enhancement techniques when underwriting leases, as well as consider new methods for boosting a tenant's credit into the acceptable range.

This article will first examine several general issues regarding credit enhancements, then review and analyze the various types of credit enhancements utilized in today's leasing market and, finally, examine certain bankruptcy issues which become critical in the analysis of credit enhancements. The article is supplemented with certain drafting tips and forms which may prove helpful to the leasing practitioner.

### II. General Issues Regarding Credit Enhancement.

#### A. Determination of Amount and Type.

In determining the amount and type of credit enhancement to be utilized in connection with a particular lease, landlords and tenants should examine a variety of factors, including the following:

##### 1. Credit of Tenant.

The most important consideration a landlord addresses when determining the need for credit enhancement is the credit of the tenant. If the tenant has a strong balance sheet, the landlord may waive the requirement of any credit enhancement. However, often the tenant does not have sufficient credit to support the lease without some further assurance or support from an outside source. It is in these cases that the landlord must evaluate the totality of the circumstances and determine the amount and type of credit enhancement that would be acceptable.

In evaluating the credit of a tenant, it is extremely important for the landlord to understand the tenant's entity structure to ensure that the landlord is receiving the credit it is expecting to receive on the lease. Many landlords unwittingly accept the signature of a subsidiary of a larger well known entity, mistakenly believing that they are receiving the credit of the parent company.

The credit of the tenant may also have an impact on the value of the real estate of which the premises is a part. While the income generated from the leases is a crucial factor in determining the value of the property, purchasers and lenders also must evaluate the creditworthiness of the tenants

under those leases when underwriting an acquisition of or loan with respect to the real estate. Therefore, while landlords certainly must be concerned with the amount of rent being paid under a lease, they must be equally concerned with the underlying credit of the tenant under the lease.

#### 2. Landlord's Investment.

The amount of money invested by the landlord in the leased space will also factor into the determination regarding credit enhancement. A landlord often "finishes out" the leased space to the tenant's specifications or provides the tenant with an allowance to do its own finish work, and the landlord seeks to recoup its investment through the rent. Therefore, generally speaking, the more a landlord has invested in a leased space, the more concerned the landlord will be with obtaining some form of security for the tenant's obligations under the lease (or, at least for the reimbursement of such investment).

3. Uniqueness of Space. A factor often overlooked by landlords when making the credit enhancement determination relates to the uniqueness of the tenant's leased space. The more unique the space of a tenant is, the more difficult re-marketing and re-letting the space becomes. Often, this leads to a longer period of vacancy between tenants and a higher cost to the landlord associated with renovating the space. In that regard, landlords should consider the cost of adaptability to use by another tenant when determining the required amount and type of credit enhancement.

#### 4. Time Needed to Relet Space.

The time a landlord needs to relet the space is also a consideration, apart from the specialized nature of the premises. In a market with high vacancy rates, for

example, a landlord may desire a greater deposit securing the tenant's lease obligations to offset the probability of a greater vacancy time after a default. Of course, market forces may prevent a landlord from doing so in a "tenant's" market.

### **B. Partial Credit Enhancements.**

During the course of negotiations, landlords and tenants sometimes negotiate "partial" credit enhancements, which may take the form of (i) a "springing" obligation or (ii) a "burnoff" feature. These are often negotiated solutions for tenants who either (a) have sufficient credit today, but their long term viability is questionable, or (b) currently do not have sufficient credit, but the parties believe that the tenant's financial standing will significantly improve over the course of the lease term.

1. "Springing" Enhancements. A credit enhancement vehicle may be structured in such a way as to only become applicable upon the occurrence of a certain event. This most often takes the form of a "springing" guaranty or a "springing" letter of credit requirement. In each of these cases, the guaranty or the letter of credit, as the case may be, is only required upon the happening of a certain event (*e.g.*, the tenant's net worth falls below a certain level). If this form of enhancement is utilized, it is important that the lease clearly define both (i) the trigger mechanism, and (ii) the landlord's ability to obtain the information necessary to determine the applicability of the triggering event (*see* Exhibit "A").

2. Burnoff Features. A credit enhancement may also be structured in such a way as to either (i) terminate after a certain event, or (ii) gradually decrease over time until the obligation ultimately terminates.



Once again, the burnoff of the credit enhancement may be tied to the tenant's balance sheet (e.g. achieving a certain net worth), but in other circumstances a landlord may release the credit enhancement if, after a number of years, the tenant has not defaulted in any of its obligations under the lease.

### C. Lease Drafting Tips.

In a lease that requires credit enhancement, landlords should ensure that certain general principles are addressed in the lease document, regardless of the credit enhancement vehicle used (see Exhibit "A" for examples of the provisions described below). Some of those principles are as follows:

#### 1. Applicability to All Defaults.

Landlords should ensure that the lease expands the applicability of the credit enhancement vehicle to all lease defaults (not just failure to pay rent). Otherwise, if a tenant defaults on a non-rental obligation, the landlord will not be entitled to avail itself of the security. Tenants may argue that the security is only in place to satisfy monetary obligations, but a prudent landlord will note that virtually all lease defaults can be reduced at some level to a monetary obligation.

#### 2. Option to Pursue Other Remedies.

The lease should specify that while the security may be applied by the landlord to cure a default, it should not be considered "liquidated damages" for such default and that such remedy is cumulative of any other remedies available to the landlord. The language in the lease should clearly provide that the security is not intended to take the place of any other damages or remedies to which the landlord may be entitled. In fact, the landlord should be entitled to pursue any

other remedies available, whether contractual, at law or in equity.

3. Replenishment. The lease should specify that if the landlord chooses to apply the security to a default and the lease is not terminated, the tenant is under an ongoing obligation to replenish the security to the originally required amount. This is true not only for a cash security deposit which is applied by the landlord to cure a default, but also a letter of credit or lease bond which is drawn upon by the landlord to cure a default.

4. Transferability. Care should be taken in the drafting of the lease and other documents to ensure that the security is transferable to a subsequent owner of the property. While the transfer of a cash security deposit is a simple matter, the transfer of a letter of credit or lease bond is somewhat more problematic because most letters of credit and lease bonds are not assignable. A more detailed discussion regarding assignment of security deposits, letters of credit and lease bonds is set forth in the sections of this article describing those instruments.

5. Survival of Landlord's Rights. In the absence of a survival clause, the tenant's liability for damages may end when the lease terminates. As such, the landlord should reserve the right to apply the security to damages that either (i) are not discovered until after the expiration or termination of the lease or (ii) actually occur during the tenant's vacation of the premises. The lease should also provide an indemnification from the tenant for those matters which will survive the termination or expiration of the lease. The tenant will obviously require that the landlord not hold the tenant's security in perpetuity, but the lease should provide that the security remain in place for at least a reasonable period after termination of the

lease and vacation of the premises by the tenant.

### **III. Discussion of Types of Credit Enhancement.**

#### **A. Cash (or cash equivalent) Security Deposit.**

1. General Description. The most common form of credit enhancement is a cash security deposit, whereby the tenant deposits cash with (or pledges a cash equivalent to) the landlord as security for the tenant's obligations under the lease. While the landlord would obviously prefer to hold a cash deposit, the tenant may prefer to pledge a cash equivalent (such as government bonds, commercial paper or even marketable securities) which do not necessarily tie up the tenant's available cash.

2. Nature of Cash Deposit. When a cash deposit is taken as security, the landlord does not have an absolute current right to such deposit. Therefore, the deposit is not treated as taxable income to the landlord until the year in which the landlord's rights to the funds become absolute (that is, when the tenant defaults and the deposit is applied thereto).<sup>1</sup> However, a landlord may structure the cash deposit as an advance payment of rent, in which event it (i) is not refundable to tenant, and (ii) is considered "earned" by the landlord in the year in which such rent is applicable. The landlord must understand that this form of advanced rental is not a security deposit in the true sense of the word because the landlord will not be able to resort to these funds to cure tenant defaults (although it does provide "security" in that

the landlord is assured that the corresponding rent payment(s) are made).

3. Transferability. The lease should provide that upon a sale of the property (and the corresponding assignment of leases), the security deposit is transferred to the purchaser and the landlord is not liable to the tenant for the return of the security deposit. A prudent tenant will condition this limitation upon (i) the actual transfer of the deposit to the purchaser, and (ii) an express assumption of the landlord's liability with regard to such deposit by such purchaser. In that regard, a landlord should always require the purchaser of the property to specifically assume in writing the obligations of the landlord under the lease with respect to the security deposit provided by the tenant.

4. Duties of Landlord. While outside the scope of this article, landlords should always be aware of the duties placed upon landlords with respect to the holding, accounting for and return of security deposits to tenants, (including whether the landlord can commingle the security deposit with its other funds or if the landlord is required to maintain a separate account for such deposits). State laws vary on these topics, so the leasing practitioner should pay particular attention to these issues when advising his or her client with respect to the drafting and administration of the lease.

#### **B. Guaranty.<sup>2</sup>**

1. General Description. Another common form of credit enhancement is the guaranty, whereby a third party (often a parent company or other affiliate of the tenant) acts as a surety with respect to the responsibilities of the tenant under the lease.

<sup>1</sup> See *Warren Serv. Corp. v. Commissioner*, 110 F.2d 723 (2d Cir. 1940).

<sup>2</sup> See generally Friedman, Milton R., *Friedman on Leases*, Ch. 35(4th ed. 1997).

A properly drafted guaranty will make the guarantor "primarily" liable for the obligations of the tenant under the lease.

2. Suretyship Defenses. While most landlords understand the concept of the guaranty as a credit enhancement vehicle, many landlords fail to understand the importance of the actual *substance* of the guaranty. As a result, many guaranties accepted by landlords fail to provide the protection sought by the landlord.

The law of suretyship provides guarantors certain protections or defenses which, if not specifically waived, could result in the total release of the guarantor from the obligations under the lease. These "defenses" most often are based on conduct of the parties after execution of the lease which alters the guarantor's obligation. For example, if the lease is subsequently modified after the execution of the guaranty, the guarantor may be relieved from liability because of its promise to guarantee the lease as written only.<sup>3</sup> Likewise, the guarantor's obligations may cease if the tenant relocates because the tenant would then be occupying a different space than the space that the guarantor had originally agreed to guarantee.<sup>4</sup> Additionally, if the tenant assigns the lease, the guarantor may be relieved of its obligations, since the assignment could be construed as a lease modification.

Even in situations in which the landlord tries to help both itself and the tenant, the landlord can find itself without a guaranty. Specifically, if the landlord agrees to extend the deadline for payment of rent, the guarantor's obligation may be eliminated

because this creates a "new" obligation.<sup>5</sup>

To avoid an unintended release of the guarantor, the guaranty should contain waivers of the common suretyship defenses (see the form of Guaranty set forth on Exhibit "B"). These waivers are critical to the landlord receiving the benefit of its bargain with respect to the guaranty. In addition to these protections required in the guaranty instrument, the landlord should also, as a matter of practice, always obtain the guarantor's written consent to any modification of the lease.

3. Joint and Several Liability. Both the tenant and the guarantor should be jointly and severally liable to perform the tenant's obligations under the lease. In that regard, the landlord should have the right to enforce the guaranty without first exhausting its remedies against the tenant. Thus, the guaranty should be a "guaranty of performance," rather than a mere "guaranty of collection." If the guaranty provides that it is only a "guaranty of collection," the landlord may be required to pursue all remedies against the tenant before collecting on the guaranty. The broader "guaranty of performance" also ensures that the guarantor is responsible for a default in the performance of any of the tenant's obligations under the lease, and not just a default in the payment of rent.

4. Exhaustion of Remedies. If a lease requires a security deposit in addition to the guaranty, the landlord will generally resist a requirement that the landlord deplete the security deposit before seeking reimbursement from the guarantor. Many guarantors will argue that the landlord should resort to the security deposit or other remedies prior to enforcing the guaranty.

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<sup>3</sup> See 38 Am.Jur.2d, Guaranty §§ 77-97.

<sup>4</sup> See *id.*

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<sup>5</sup> See *id.*

This point may have some merit in the case where the guarantor is not an affiliate of the tenant, but the landlord should generally not have to exhaust its remedies against the tenant before holding the guarantor financially responsible (particularly in the case of an affiliated guarantor).

5. Landlord Priority *vis-a-vis* Guarantor. The guaranty should specify that if the tenant defaults, the default must be cured before the guarantor can enforce its subrogation rights against the tenant. Further, the landlord, and not the guarantor, should have priority with respect to the tenant's assets.

6. Waiver of Notices. The landlord should have no obligation to send, and should obtain a waiver from the guarantor regarding, any notices to the guarantor which may be required before the guarantor must perform its obligations. However, if the guarantor is not affiliated with the tenant, the guarantor may resist this waiver.

7. Lease Transfers and Extensions. The guaranty should expressly provide that the guarantor is not released from its obligations if the tenant sublets or assigns its interest in the lease. The guaranty should also specify that the guarantor remains liable for any additional lease terms during which the tenant occupies the space and any periods during which tenant holds over after the lease ends.

8. Authority Issues. The landlord should always ensure that the person signing the guaranty has the authority to bind the proposed guarantor. In certain circumstances, additional signatures or approvals may be necessary in order to bind the guarantor. For example, in the case of an individual guarantor, in a community property state, the guarantor's spouse should also sign the guaranty or the landlord might

not be able to recover the guarantor's assets that qualify as community property. Also, if the guarantor is a corporation or other entity, the guaranty must be authorized by proper corporate or other applicable procedures. In that regard, the landlord should require evidence that the entity has been authorized to enter into the guaranty. Finally, the guaranty should clearly provide that the guarantor's obligation does not terminate upon the guarantor's death or incapacity, but the guarantor's estate remains obligated under the guaranty.

9. Credit Maintenance. The landlord may want to include in the guaranty the right to monitor the guarantor's financial standing by requiring the guarantor to submit periodic financial statements. If the guarantor's income or other specified financial indicia drop below a certain level, the landlord may require the tenant to provide additional credit enhancement.

10. Partial Guaranty. Generally, the landlord will not want a limit on either (i) the amount for which the guarantor is liable nor (ii) the duration for which the guarantor is liable. However, in certain circumstances, the landlord and tenant may agree to limit the guarantee in such a manner. In such cases, the lease should clearly specify the parameters for limiting the guarantor's liability.

11. Other Enforcement Issues. The guaranty should also provide that the guarantor is required to appoint the tenant as its agent for service of process and that the guarantor is required to pay all of the landlord's legal fees arising from or in connection with the enforcement of the guaranty.

12. Form of Guaranty. It should be clear from the foregoing discussion that a brief addendum typed at the bottom of the

lease is insufficient to serve as a guaranty. A separate, more thorough guaranty (like that provided in Exhibit "B") will allow the landlord to more fully realize the complete benefit of this credit enhancement vehicle.

### C. Letter of Credit.

1. General Description. A tenant that does not want to tie up its cash in a security deposit and is not willing or able to provide an acceptable guaranty may desire to post a letter of credit as a form of security for its lease obligations. A letter of credit is an agreement in which a bank (issuer) is requested by its customer (tenant) to honor a demand for payment by a third party (landlord) upon compliance with any conditions specified in the instrument. While the issuer may require its customer to post collateral, it may often be less than the otherwise required cash deposit.<sup>6</sup>

2. Form of Letter of Credit. A landlord should ensure that a letter of credit is drafted in such a way as to preclude complications in the event a landlord seeks to draw upon it. Inadequately drafted letters of credit (or lease sections addressing letters of credit) may result in a landlord not having the security it thought it bargained for. As such, the lease should specify that the form and substance of the letter of credit must be acceptable to the landlord, or simply attach a form of letter of credit to the lease (*see* Exhibit "C"). Generally speaking, a landlord will require an irrevocable, standby letter of credit, which is a contingent obligation of the issuing bank to make payment to the designated beneficiary if the bank's customer (*i.e.* the tenant) fails to

perform as called for under the terms of the lease.

3. Approval of Issuer. The lease should provide that the bank that issues the letter of credit must be acceptable to the landlord. This is significant because a letter of credit is a general obligation of the bank, not an insured account, so the landlord should be comfortable with the financial ability of the issuing bank to perform.<sup>7</sup>

4. Irrevocable. Since a letter of credit is generally revocable at will, a landlord should require the letter to specifically state that it is irrevocable.<sup>8</sup> If it is not irrevocable, the issuer (bank) may revoke it at any time, leaving the landlord without any security.

5. Sight Draft. The form of sight draft (or draw request) required to draw upon the letter of credit should be attached to the letter of credit. (*See* Annex "A" to Exhibit "C") The requirements of the sight draft should be as simple as possible so that there are no extraneous obligations on the landlord or pitfalls whereby the request may be denied by the issuing bank. The only obligation of the landlord to draw on the letter of credit should be the landlord's certification that tenant is in default under the lease. Aside from this certification, a letter of credit should not contain any conditions precedent to the issuer's funding of the request (*i.e.*, the issuer should not

<sup>6</sup> Often, a creditworthy tenant will have the ability to obtain a letter of credit from its bank as part of the credit package it maintains with the bank.

<sup>7</sup> See Sidney G. Saltz, *Nonresidential Security Deposits*, 27 Real Est. L. J. 225, 248 (Winter 1999).

<sup>8</sup> Under the Uniform Customs and Practices for Documentary Credits (1993 Revision) International Chamber of Commerce Publication No. 500 ("UCP") and Article 5 of the Uniform Commercial Code, in the absence of any indication of revocability, "the credit shall be deemed to be revocable." UCP, Art. 1(c).

have any obligation to research any factual representations made in the sight draft or to make any judgment as to their accuracy). Therefore, the letter of credit should explicitly state that it is to be honored by the issuer without any inquiry, regardless of whether the tenant disputes the validity of the underlying default.<sup>9</sup>

6. Term. While a letter of credit is usually issued for twelve months, lease obligations may continue well beyond that date. There are two options to address this issue:

a. Substitute Letter. The landlord's first choice may be to require the tenant to substitute a renewal letter of credit. The lease clause should provide that any replacement letter must be in the landlord's possession and take effect not later than 30 days prior to the expiration of the previous letter of credit. This allows an overlap period in which the landlord can draw on the expiring letter if no renewal is provided. In that regard, the specific representation in the letter of credit addressing this issue should state that the landlord can draw on the letter if it certifies that a replacement letter has not been provided in accordance with the lease.

b. Evergreen. A second option is to include an "Evergreen Clause" in the letter.<sup>10</sup> Under this clause a letter of credit automatically renews each year during the lease term unless the bank gives the landlord notice that it will not renew the letter. Obviously, in this event the lease should provide that the tenant will provide substitute collateral prior to the expiration of

the existing letter of credit in the event the bank provides notice of non-renewal.

7. Multiple Draws and Replenishment. The letter of credit should specifically state that multiple draws up to the stated amount are allowed. Further, a properly drafted lease will require that the tenant be obligated to provide a replacement letter of credit in the amount drawn by landlord or provide landlord with other security acceptable to landlord to promptly restore the security to its full amount.

8. Presentment Location. The lease should require that the letter of credit be payable in the city in which the leased premises are located (or the city in which the landlord is located, if more convenient). This assures that the landlord will not have to present the letter of credit for payment in another city in which the bank has its main office or where its letter of credit department is located.

9. Transferability. Unless a letter of credit explicitly states that it is transferable, a successor-in-interest to the landlord (e.g., purchaser or lender) is not entitled to its benefits. As such, a landlord will want to add language to the letter of credit to the effect that the letter of credit is transferable without any charge (or for a nominal transfer fee) to any successor or assignee of the beneficiary. If the letter of credit is not assignable, then the existing letter of credit would need to be cancelled and a new letter of credit issued to the successor in interest to the landlord. Accordingly, the lease should provide that the tenant is required to post a new letter of credit or otherwise cooperate in the transfer of the existing letter of credit to a successor landlord. The lease should also provide that the tenant is responsible for paying any transfer fee required by the issuer.

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<sup>9</sup> See *The Ins and Outs of Using Letters of Credit in Lease Transactions*, Commercial Leasing Law and Strategy, July 1995.

<sup>10</sup> See *id.*

While a landlord may want the letter of credit to be specifically assignable, a tenant may not want the letter to be assignable in the event that the tenant transfers its interest under lease. As such, the tenant should ensure that the lease allows the tenant to terminate the existing letter of credit when the sublessee or assignee provides a substitute letter of credit acceptable to the landlord.

10. Lease Language. Many of the concepts discussed in this section regarding letters of credit are illustrated in the lease inserts set forth on Exhibit "A."

#### **D. Lease Bond.**<sup>11</sup>

1. General Description. Another alternative that is similar in function to a letter of credit is a lease bond — an arrangement under which, upon default, the landlord looks to a surety company for payment (and the surety company seeks reimbursement from the defaulting tenant).

Under a lease bond, the tenant is referred to as the "principal," the landlord is referred to as the "obligee" and the surety company is referred to as the "issuer" or "surety." Often called "miscellaneous indemnity bonds" by sureties, they are used frequently in the utility industry for a commercial consumer's payment guaranty. A utility company will usually require two to three months' forward estimate in usage fees as a security deposit that it will keep for several years until the customer has established a good track record, at which time the security deposit/bond is no longer needed.<sup>12</sup> Because utility expenses, and the

corresponding deposit, can be substantial, large companies often look to insurance companies to underwrite a bond for the deposit. Often these companies have excellent credit; therefore, insurance companies do not face much risk in undertaking the obligation and often do not require the principal to post any collateral. Such bonds are also sometimes used for equipment lease deposits and commercial lease deposits, though much less frequently.

2. Limited Use. Today, surety bonds in the real estate lease context are not favored by surety companies because of the perception of large risk (that the lease bond is the security deposit of last resort for the least creditworthy parties) and small reward. When they are used, it is usually for preferred customers as an accommodation.

3. Financial Disclosure. The amount of disclosure required to obtain a bond varies according to the credit of the tenant. Large companies may only need to provide a few years' worth of audited financial statements. Start-ups, on the other hand, often must produce business plans, copies of the lease, financials and other investor information.

4. Indemnity Requirement. The tenant/principal will normally be required by the surety company to sign or provide an indemnity. Oftentimes the indemnitor is a third party related to the tenant. A third-party indemnitor would be required if a same party indemnitor (the tenant itself) does not have the financial wherewithal to be an acceptable indemnitor to the surety company.

5. Surety Defenses. Absent an agreement to the contrary, the surety company issuing the bond will have the right to assert as a defense to payment of the bond that the tenant is not in default under

<sup>11</sup> Special thanks to James P. Fulton of Harris F. Underwood III, Inc. at (214) 752-9500, [jimf@theunderwoodagency.com](mailto:jimf@theunderwoodagency.com).

<sup>12</sup> Utilities in at least two states (Oklahoma and Alabama) require the security indefinitely.

the lease. In addition to the standard surety defenses, the surety will use its investigation period under the bond to make this determination. Therefore, the ideal situation for the landlord is to negotiate a bond containing no defenses to collection from the surety.

6. Transferability. Generally speaking, an indemnity bond will follow the underlying obligation secured by the bond. Therefore, it is arguable that the benefits of the lease bond would be transferred to a subsequent purchaser of the property from the landlord. However, given the dearth of case law regarding lease indemnity bonds, it would be prudent for the landlord to take a couple of courses of action to ensure the bond's transferability. First, the lease should provide that upon a transfer of the property by the landlord, all of the rights and benefits pertaining to the property (including any security for tenant's obligations), will be transferred to the transferee. Second, the bond itself should specifically provide that it is transferable to a subsequent owner of the property.

7. Drafting Tips. In drafting or negotiating the form of surety bond for a specific lease, the parties should include precise explanations of the claims process (including notice and cure periods, investigation periods and a time line for making a claim and payment thereof). In addition, the landlord should attempt to mirror the provisions of a lease bond to that of the already discussed letter of credit. Following are some specific issues to bear in mind when drafting lease bond provisions.

a. Irrevocable. Like the letter of credit, all landlords would prefer to have the bond be made irrevocable, or if not, it should contain an adequate notice period before termination allowing the tenant to post replacement security.

b. Surety Rating. The landlord should require the surety company issuing the bond to be financially stable, and should check its rating with Best's Insurance Reports or a comparable rating agency.

c. Duration/Renewal. The tenant should be responsible for renewing the bond at least 30 days before the current lease bond expires and the lease bond should remain effective for at least 60 days after the termination of the lease.

d. Costs/Fees. The landlord should require the tenant to pay all costs of obtaining, maintaining and extending the lease bond. The tenant will want the landlord to repay any and all amounts that were not authorized to be drawn. The lease should specify that once the landlord is paid by the surety, the amount paid will be considered part of the security deposit, and customary security deposit provisions should accordingly be included in the lease with respect thereto. These sums can then be used in any way the lease would allow a security deposit to be used.

e. Replenishment. If a landlord draws upon the lease bond, the tenant should be required to promptly restore the amount drawn. This is a similar concept to a replacement letter of credit or replacing any part of a cash security deposit. To restore the draw on the bond, the tenant may either give the landlord a new lease bond for the amount drawn or amend the existing lease bond. In either case, this should be specified in the lease itself. The lease should specify that the landlord may present the lease bond for payment when certain events occur (*e.g.*, tenant default, failure to replace or amend existing lease bond, etc.).

Similarly, if the bond is revocable, the lease should state that the tenant must provide replacement security if the surety



elects to cancel the bond. Also, as mentioned, if the bond is revocable, it should require that the surety give sufficient notice to landlord and tenant prior to termination.

f. Tenant Cooperation. A tenant should be required to cooperate with the landlord in obtaining any reasonable modifications or replacements needed to the lease bond.

g. Time to Pay. The landlord should scrutinize the bond to ensure that the surety does not have an unlimited amount of time during which it may investigate the claim before paying the landlord. The bond should provide that the surety "will immediately" honor a draw request, or at least limit the surety's time to investigate.<sup>13</sup> The bond should also clearly state any defenses that the surety has to payment, if any.

8. Bond Form and Lease Language. While a form of Lease Bond is provided in Exhibit D, it should be used with caution because a bond of this nature is lease specific. In addition, Exhibit A sets forth certain lease provisions relating to the surety bond, which provisions also should be tailored to the specific lease agreement.

### **E. Landlord's Lien on Tenant's Property.**

1. General Description. Typically a supplement to another form of credit enhancement, a landlord may contractually create a lien on the tenant's personal property located in the premises. In some states, including Texas, a landlord also has a statutory lien on the tenant's personal property for non-payment of rent.

### 2. Contractual Lien.

a. Generally. Most landlord form leases include the grant of a contractual lien upon the tenant's personal property (e.g., equipment, furniture, inventory, merchandise, accounts receivables, fixtures, etc.). A search in both the local property records and the records of the Secretary of State is appropriate to determine whether other creditors have filed financing statements evidencing liens with respect to the tenant's property. In many jurisdictions this lien will allow the landlord to obtain possession of the tenant's property and sell it for unpaid rents. If the lien provision is drafted properly, the sale proceeds may be used to reimburse the landlord for any amounts owed by the tenant. The lease should bar the tenant from removing any of its personal property without the landlord's consent (except for sales to customers in the ordinary course of tenant's business).

b. Description of Property. The contractual landlord's lien should be specifically described in the lease itself. The lease should specify exactly what the lien will cover (whether it be merchandise, fixtures or improvements) and it should extend to proceeds as well.

c. Priority. To have priority with respect to the claims of future creditors of the tenant, the lien must be perfected by filing a financing statement (UCC-1) in the appropriate location. Therefore, the lease should require the tenant to sign a financing statement or allow the landlord to sign the financing statement on the tenant's behalf. Additionally, the lease could provide that the lease itself may be filed and served as the financing statement (although state laws may vary on this topic).

d. Other Liens. The lease should specify that the tenant will not allow any

<sup>13</sup> The attached form provides for 15 days.

other lien to be filed on the property that might have priority over the landlord's lien. However, certain lenders' liens will have priority even if they are filed after the landlord's lien.<sup>14</sup> Specific state rules addressing this and other rules of the priority system can be found in Article 9 of the Uniform Commercial Code (the "U.C.C."). Article 9 of the U.C.C. has been revised (effective July 1, 2001 in many jurisdictions), so care should be taken to review revised Article 9 and determine whether it has been adopted by the relevant jurisdiction and, if so, when it will go into effect and what effect such changes have on the perfection and priority of this lien.

### 3. Statutory Lien.

a. Generally. The above described contractual lien is in addition to any statutory lien provided in the jurisdiction in which the premises are located. At common law, a landlord had a right of distraint for rent that allowed it to seize a tenant's personalty to pay rent arrearages. This has been abolished in certain states and replaced by a statutory lien.<sup>15</sup>

b. State Law Specific. The rules addressing statutory liens vary from state to state. For instance, the lien may cover all of the tenant's monetary obligations or may cover rent (or a portion thereof) only. Likewise, the statutory lien automatically expires after the passage of time in some jurisdictions. In any case, the lease should clearly state that the rights afforded to landlord by the contractual lien are in addition to the statutory lien. The reasons a

landlord may require a contractual lien in a state which grants a landlord a statutory lien on the tenant's personal property are (i) to "plug any holes" in the statutory system and (ii) to provide the landlord with potentially an easier means of enforcement and recovery than the statutory regime provides.

4. Waiver of Liens. A tenant with strong credit may seek to have the landlord waive the statutory lien and not require any contractual lien. This is purely a lease underwriting issue and the determination of the need for such a lien should be subject to the same analysis as the other credit enhancement vehicles.

5. Subordination of Liens. Most lenders providing financing to a tenant for its equipment or inventory will require a subordination of the landlord's lien in order to provide such financing. Landlords, recognizing the need of a tenant to conduct its business, generally agree to such a subordination.

6. Lien Remedies. In the case of statutory liens, the laws of the particular jurisdiction in which the premises are located will govern the landlord's remedies in the event the tenant defaults. For contractual liens, the written terms of the security agreement (usually contained as a provision of the lease entitled "Landlord's Lien"), coupled with Article 9 of the U.C.C. govern the landlord's options upon a tenant default. Generally, Sections 9.501-.507 of the U.C.C. address the right and obligations of the parties upon a default.<sup>16</sup> Nevertheless, the lease provisions should specify exactly what the landlord is entitled to do if it chooses to enforce the lien, such as entering the tenant's space, taking its

<sup>14</sup> See Uniform Commercial Code ("UCC") § 9.302 (e.g., purchase money security interest in consumer goods).

<sup>15</sup> See generally 49 Am.Jur.2d, Landlord & Tenant §§ 726 & 942-69; TEX. PROP. CODE Ch. 54.

<sup>16</sup> *N.B.*, these section references change upon the revised Article 9 taking effect.

property and selling it at a public or private sale. For instance, Section 9.503 of the U.C.C. allows a creditor to require the debtor to assemble the collateral but only if the security agreement specifically allows that. The proceeds of the sale of the property should be applied to the amounts owed the landlord, but if the proceeds do not cover the amount owed, the tenant should be made responsible for the difference.<sup>17</sup> The lease should make it clear that any attorneys' fees the landlord incurs in taking the property, exercising its rights pursuant to the lien or any other related activity will be included in the amounts owed to the landlord.

7. Form of Landlord's Lien and Lease Language. A sample lease provision containing landlord's lien language is set forth in Exhibit E attached to this article.

#### **F. Equity Participations and Start-Ups.**

Occasionally, a landlord may be afforded the opportunity to take an equity position in a tenant's business. This opportunity is often in addition to, not in lieu of, another form of credit enhancement. Equity kickers are especially prevalent in the high tech arena because the burn rate of capital (both venture capital and private placement money) is very high. If a tenant is able to lower its rental rate or reduce the amount of security that would otherwise be required under a lease, the tenant is able to spend more of its cash on its core business. Therefore, offering the landlord the opportunity to participate in the profits of the tenant's business in exchange for a reduction in the tenant's cash outlay could be a "win-win" situation for the landlord and

tenant. However, now that the bloom is off the flower with respect to high-tech tenants, looking at the risk involved with leasing to startups, landlords generally view equity kickers as inducements to, rather than enhancements for, entering the lease.

The main problem with equity participation in start-ups is the valuation of the company. Since there is no true "market" for the company's shares and many of the companies have never posted a profit, it is difficult to determine the true value of the company (and consequently the shares of the company). A prudent landlord will engage a third party investment advisor to advise it with respect to the valuation of the company and the landlord's participation.

#### **IV. Critical Analysis – Comparison of Different Forms of Credit Enhancement.**

Each of the foregoing credit enhancement vehicles has certain advantages and disadvantages from both the landlord's and the tenant's perspective. This section of the article will compare the various forms of credit enhancement and analyze the unique characteristics of each.

##### **A. Cash Security Deposit**

###### **1. Tenant's Perspective.**

The most significant advantage to tenant of a cash security deposit is that the administrative hassle of providing this form of security is not present as in obtaining a letter of credit or lease bond. However, the disadvantage to the tenant of providing a cash security deposit is that this cash is tied up during the term of the lease and is therefore not working to benefit the tenant.

###### **2. Landlord's Perspective.**

From the landlord's perspective, the advantage of holding a cash security deposit

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<sup>17</sup> See specifically, U.C.C. § 9.504 regarding the application of proceeds.

is that the landlord may apply the security deposit to a default immediately, without having to clear various hurdles to access the money. On the other hand, the landlord must deal with the administrative procedures for handling the security deposit. This will require following the applicable procedures of state law with respect to holding the security deposit and returning it to the tenant at the end of the lease. Also, cash may be the least effective form of security deposit for the landlord in the event of tenant's bankruptcy. See the discussion in Section V below.

## **B. Guaranty**

### **1. Tenant's Perspective.**

The advantage to the tenant of providing a guaranty is that this guaranty typically comes at no out-of-pocket cost and can be obtained more quickly than a lease bond or letter of credit. The tenant does not need to tie up any of its cash, nor does the tenant need to pay a fee, as it would to obtain a letter of credit or lease bond. However, if the tenant assigns the lease or sublets the premises, the guarantor may not be released from its guaranty, unless the lease specifically allows the tenant to substitute a replacement guarantor. This greatly increases the guarantor's exposure, in that it has waived all suretyship defenses, and does not have an affiliate relationship with the new tenant.

### **2. Landlord's Perspective.**

From the landlord's perspective, the guaranty of a credit worthy entity provides the ultimate form of credit enhancement, because it typically guarantees all of the tenant's obligations under the lease, as opposed to only a portion of the obligations (as is generally the case with the other forms of credit enhancement). Also, a guaranty

may be preferable to a lease bond because a guarantor affiliated with the tenant is more likely to waive the suretyship defenses than a surety company providing a lease bond. Further, as discussed further in Section V below, a guaranty is not affected by tenant's bankruptcy.

On the negative side, the efficacy of the guaranty is limited to the credit of the guarantor. A letter of credit or lease bond will often provide the landlord with an entity having superior credit standing behind tenant's obligations under the lease. The disadvantage versus a cash security deposit, is that landlord must proceed against the guarantor, and may have to file suit, in order to enforce the guaranty, which will result in greater expense to the landlord and a longer time period before it has access to the security.

## **C. Letter of Credit.**

### **1. Tenant's Perspective.**

The most significant advantage to a tenant providing a letter of credit is that a letter of credit allows a tenant to avoid tying up large amounts of cash, as is the case with the more traditional cash security deposit. In addition, even if a tenant is required to deposit funds with the issuing bank to secure the letter of credit, the tenant can earn interest on these dollars (which hopefully will be greater than the fee charged by the bank to issue the letter of credit). Another advantage to the tenant of providing a letter of credit is that, unless drawn upon, the letter of credit will automatically expire shortly after the lease term. This can be a better situation for a tenant than a cash security deposit, in which the tenant sometimes finds itself battling with the landlord several months after the lease has expired in an attempt to have its funds returned.

The major disadvantage to the tenant in using a letter of credit is that, because the letter is independent of the contract between the landlord and tenant, the tenant usually has no ability to contest the landlord's draw of the letter of credit to satisfy an alleged default. While this is no different than the position a tenant finds itself in with respect to a cash security deposit, it is a less desirable position for the tenant than if the credit enhancement vehicle was a guaranty by an affiliate of tenant (whereby the tenant could presumably control the flow of funds during a lease dispute).

#### 2. Landlord's Perspective.

A major advantage to the letter of credit form from the landlord's perspective is the same as the major disadvantage from the tenant's perspective. That is, the landlord is entitled to draw upon the letter of credit upon a default by the tenant, without tenant interference. In addition, unlike a cash security deposit, the landlord need not concern itself with the possible hassle of accounting for and returning an unused cash deposit. The landlord simply allows the letter of credit to lapse after the term ends. Additionally, the letter of credit is advantageous from a bankruptcy standpoint, as is more particularly described in Section V of this article.

A disadvantage to the letter of credit from a landlord's perspective is that the letter of credit often creates difficulty for the landlord in connection with a financing or sale of the property. Unless the lease and letter of credit are property drafted, the landlord may have a difficult time convincing a lender to underwrite the letter of credit, because the lender may not be convinced it will have access to the collateral upon a foreclosure. Likewise, upon the sale of the property, transferring the letter of credit may present a problem for

the landlord. Finally, while not substantial, the time and expense incurred in connection with drawing on the letter of credit are greater than that required to apply a cash security deposit.

### **D. Lease Bond.**

#### 1. Tenant's Perspective.

A tenant may prefer a bond, which, unlike a letter of credit, often will not affect the tenant's balance sheet. In addition, the collateral, if any, required by the surety company is likely to be less than the cash security deposit. On the other hand, sureties require extensive financial data from the tenant and fees may be higher than for a letter of credit. Such fees commonly run up to three percent of the amount of the bond — a yearly amount like most other insurance premiums. Not uncommonly, however, if the risk is high, this fee may reach five percent of the bond amount. The surety may also require collateral depending upon its underwriting of a bond for a tenant.

#### 2. Landlord's Perspective.

A landlord benefits from the bond underwriting process in that there exists another set of eyes that will scrutinize the creditworthiness of the tenant. It is unlikely that a financially unstable tenant will qualify for a lease bond, at least without a creditworthy indemnitor. Additionally, the lease bond is advantageous from a bankruptcy standpoint, as is more particularly described in Section V of this article.

The major disadvantage to the landlord of the lease bond form of credit enhancement is that, unless landlord is able to obtain an unconditional bond including the surety's waiver of suretyship defenses, the surety will undertake an investigation

before paying its obligation, leading to additional time before the landlord can recover on the bond. This compares unfavorably to the more immediate recovery under a cash security deposit or an unconditional letter of credit. Further, the landlord must be careful not to modify the tenant's obligations under the lease without obtaining the surety's consent (an unenviable and time consuming task), or the landlord will risk losing the surety's obligation to perform or the bond.<sup>18</sup>

In addition, because of the relative obscurity, there is no real "industry standard" relating to the form and substance of surety bonds. Therefore, this vehicle for credit enhancement may not provide the certainty of collection that other credit enhancement vehicles do.

<sup>18</sup> This may be the case even if the lease bond is drafted such that it is payable upon certification of default by the landlord because insurance companies will generally investigate in spite of any language to the contrary.

## V. Bankruptcy Issues.

**A. General Concerns.** Each form of credit enhancement discussed in this article has its pros and cons, many of which are complicated further when a landlord considers that the tenant may file for (or may have involuntarily filed against it) bankruptcy. In addition to those concerns discussed below, whenever property is transferred, such as when a security deposit is paid or a lien is granted, a landlord must consider whether the property could be recovered by a bankruptcy trustee as a preference<sup>19</sup> or a fraudulent conveyance.<sup>20</sup>

<sup>19</sup> 11 U.S.C. § 547(b) provides "...the Trustee may avoid any transfer of an interest of the debtor in property — (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made — (a) on or within 90 days before the date of the filing of the petition; or (b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and (5) that enables such creditor to receive more than such creditor would receive if — (a) the case were a case under chapter 7 of this title; (b) the transfer had not been made; and (c) such creditor received payment of such debt to the extent provided by the provisions of this title." *But see In re C.S. Mersick & Co.*, 1 B.R. 599 (D. Conn. 1979); *In re Scionti*, 40 B.R. 947 (D. Mass. 1984) (landlord's prepetition application of deposit to rent is not a preference).

<sup>20</sup> 11 U.S.C. § 548(a) provides "(1) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily — (a) made such transfer or incurred such obligation with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted..."

**B. Section 502.** A specific concern for a landlord when a tenant files for bankruptcy is Section 502 of the Bankruptcy Code, a provision that severely limits a landlord's post-bankruptcy lease rejection damages.<sup>21</sup> Specifically, Section 502(b)(6)<sup>22</sup> limits the landlord's recovery for such post-bankruptcy lease rejection damages to the greater of (i) one year's worth of rent or (ii) 15% of the rent due for the remaining term of the lease (but in no case to exceed three years). It should be noted that this limit does not apply to any pre-bankruptcy damages for unpaid rent or the like.

The Bankruptcy Code's limitation on post-rejection damages only applies to charges due under a lease that are (i) designated as "rent" or "additional rent", (ii) related to the value of the property or the lease, or (iii) fixed, regular or periodic expenses. Generally speaking, landlords prefer to characterize most monetary obligations due under a lease as "rent" in

order to avail themselves of a state's summary unlawful detainer procedures (as opposed to the lengthier breach of contract actions). However, this may lead to problems in the bankruptcy context, whereby significant amounts otherwise collectable as damages might be lost as a result of the Section 502(b)(6) limitation. The most striking example of this potential loss is in the area of tenant improvements. While a landlord generally will increase the amount of rent payable under a lease in order to recover the amount of the improvements provided by the landlord, this increased amount of rent will be subject to the Section 502(b)(6) limitation. Therefore, landlords concerned about a tenant bankruptcy may wish to consider alternative methods of financing the tenant improvements, such as having the tenant execute a promissory note which is separate and apart from the lease.

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<sup>21</sup> See generally *The Effects of a Tenant's Bankruptcy on Various Forms of Security Devices*, Jess Bressi and Scott Brooks, *Commercial Leasing Law and Strategy*, April 2001.

<sup>22</sup> 11 U.S.C. §502(b)(6) provides that "...if [ ] objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that...if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds – (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of – (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates..."

**C. Automatic Stay.** One of the most important issues for a landlord in a bankruptcy context is the automatic stay under Section 362.<sup>23</sup> Generally, the automatic stay prohibits any action against the debtor . . . specifically, it may prohibit a landlord from applying the security deposit to cure existing defaults. Further, a landlord that is otherwise "adequately protected" may also be forced to divest itself of the security deposit.<sup>24</sup> Obviously, a landlord cannot evict a tenant without first obtaining court approval or getting relief from the stay. Also, a landlord is prohibited in most cases from setting off security deposits for unpaid pre-petition rent or other damages caused by the tenant.

**D. Effect on Various Forms of Credit Enhancement.**

Based on the foregoing and other bankruptcy concerns, a landlord is best protected if it can enhance its position through mechanisms that avoid dealing with the debtor and property of the bankruptcy estate. The following discussion analyzes each of the credit enhancement mechanisms addressed in the article from the bankruptcy perspective.<sup>25</sup>

1. Cash Security Deposit. A bankruptcy filing will likely tie up a cash security deposit completely. Further, if the amount of the security deposit is more than the amount of the landlord's rejection claim,

<sup>23</sup> See 11 U.S.C. § 362.

<sup>24</sup> See 11 U.S.C. § 542(a).

<sup>25</sup> For a more thorough discussion of the effects of a tenant's bankruptcy or the various forms of credit enhancement, see *The Effects of a Tenant's Bankruptcy on Various Forms of Security Devices*, Jess Bressi and Scott Brooks, Commercial Leasing Law and Strategy, April 2001.

the excess must be turned over to the estate unless the landlord has a separate unsatisfied claim not related thereto.<sup>26</sup> However, while a deposit may not be held for claims not yet accrued, if the deposit is instead an advance payment of rent, then the tenant's trustee in bankruptcy has no claim for amounts actually applied to prepetition unpaid rent.

Additionally, claims for *post-petition* rent incurred by a debtor, prior to rejection of a lease, are entitled to administrative expense priority. The administrative expense claim is given priority over all other claims in the bankruptcy case, except for secured claims and superpriority claims. Because claims for *post-rejection* rent are capped by Section 502(b)(6), landlords should attempt to apply a cash security deposit to offset these *post-rejection* claims (claims that are least likely to be paid), thus increasing their total recovery.

2. Guaranty. A guaranty from a third party guarantor that is not itself in bankruptcy is not affected by the tenant's bankruptcy proceeding.<sup>27</sup> Absent unusual circumstances, the automatic stay will not prevent a landlord from collection actions against the guarantor.<sup>28</sup>

3. Letter of Credit. A draw upon a letter of credit can be made if the tenant has filed for bankruptcy because the automatic stay does not generally apply also to letters of credit.<sup>29</sup> While the letter of credit is not

<sup>26</sup> See *In re Atlantic Container Corp.*, 133 B.R. 980, 989 (N.D. Ill. 1991).

<sup>27</sup> See *Credit Alliance Corp. v. Williams*, 851 F.2d 119 (4<sup>th</sup> Cir. 1988).

<sup>28</sup> See *id.*

<sup>29</sup> See *In Re Paige* 18 B.R. 713 (D.D.C. 1982); *In Re Printing Department, Inc.*, 20 B.R. 677 (E.D.Va. 1981). But see *In Re Twist Cap, Inc.*, 1 B.R. 284 (Bankruptcy D. Fla. 1979).



an asset of the tenant's bankruptcy estate, certain proceeds of the letter of credit may be considered part of the bankruptcy estate. For example, those proceeds in excess of the Section 502(b)(6) cap described in this section would be considered part of the tenant's bankruptcy estate. It should be noted that letters of credit issued by banks that are outside of the bankruptcy estate but that are secured by property within the bankruptcy estate may also give rise to problems.<sup>30</sup>

4. Lease Bond. A lease bond for the benefit of the landlord is not considered property of the bankruptcy estate<sup>31</sup> and the automatic stay would therefore not prevent a landlord from collecting from the surety company under its bond.

5. Landlord's Lien. All statutorily granted liens are avoided under bankruptcy automatically. Consensual contractual liens, however, give landlords some protection in that such landlords are treated as secured creditors in bankruptcy.

6. Equity Participation. In a bankruptcy situation equityholders will not likely receive anything – if they do, they should consider themselves lucky.

## **VI. Conclusion**

The amount and type of the credit enhancement available to a tenant, and acceptable to a landlord, depend on myriad factors discussed in this article. While tenants should be aware of the alternative types of credit enhancements available, landlords should scrutinize the proffered credit enhancement for adequacy,

bankruptcy remoteness, ease of access, and many other concerns. The number of options available to the parties certainly make room for a situation in which both parties can find themselves satisfied with the result.

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<sup>30</sup> *In re Compton Corp.*, 831 F.2d 586 (5<sup>th</sup> Cir. 1987).

<sup>31</sup> *In re Lockard*, 884 F.2d 1171 (9<sup>th</sup> Cir. 1989).

**EXHIBIT A**<sup>32</sup>**DRAFTING TIPS – SAMPLE LEASE PROVISIONS**1. General

**Applicability to All Defaults/Option to Pursue Other Remedies/Not a Measure of Landlord's Damages.** [Tenant's security deposit] (the "Security Deposit") is security for the full and faithful performance and observance by Tenant of each and every term, provision, covenant, obligation and condition of this Lease and all extensions, modifications, amendments and renewals hereof. If Tenant defaults with regard to any of the terms, provisions, covenants, obligations or conditions hereof, including but not limited to payment of Rent, Landlord, at Landlord's election, which election Landlord may change from time to time, may either (a) use, apply or retain the whole or any part of the Security Deposit for the payment of any Rent or any other sum or expense that Landlord incurs as a result of Tenant's default hereunder, including any damages or deficiency in the reletting of the Demised Premises, regardless of whether such sums accrue after summary proceedings or other re-entry by Landlord or (b) pursue any and all other remedies for default by Tenant hereunder, at law or in equity. It is expressly understood by the parties that the Security Deposit is not a measure of Landlord's damages in case of a Tenant default.

**Replenishment.** Whenever and as often as the amount of the Security Deposit held by Landlord is diminished by Landlord's application thereof or for any other reason, Tenant must, within 10 days after Landlord's request therefor, deposit additional sums (or provide such Security Deposit in another form acceptable to Landlord) with Landlord sufficient to restore the Security Deposit to a sum equal to its original amount of \$ \_\_\_\_\_.

**Springing Obligation/Financial Statements.** Tenant must, at all times during the term of this Lease, maintain a tangible net worth [**define**] which is not less than \$ \_\_\_\_\_ (the 'Net Worth Requirement'). In that regard, within forty-five (45) days after the end of each calendar quarter, Tenant must provide to Landlord copies of Tenant's unaudited financial statement for such quarter, which is certified by Tenant's chief financial officer to be true and correct in all respects. In addition, within ninety (90) days after the end of each calendar year, Tenant must provide to Landlord a copy of its annual financial statement which has been audited by an independent certified public accountant acceptable to Landlord. All financial statements provided by Tenant under this Lease must be prepared in accordance with generally accepted accounting principals consistently applied. If (i) Tenant fails to provide any financial statement within the time period specified or (ii) the financial statement provided by Tenant shows that Tenant's tangible net worth has fallen below the Net Worth Requirement, then Tenant must, within ten days after demand by Landlord, provide to Landlord [**insert form of security**], and maintain such security with Landlord throughout the remainder of the term of this Lease.

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<sup>32</sup> PLEASE NOTE THAT THE INFORMATION PROVIDED IN THE EXHIBITS SHOULD OBVIOUSLY BE CAREFULLY AND THOROUGHLY REVIEWED IN ANY INSTANCE WHERE UTILIZED, AND ADDITIONAL OR ALTERNATIVE PROVISIONS OR REVISIONS SHOULD BE CONSIDERED AS MAY BE NECESSARY IN ORDER TO ADDRESS THE SPECIFIC TERMS AND CIRCUMSTANCES OF EACH PARTICULAR TRANSACTION.

**Sale of Property.** If Landlord transfers its interest in the Property during the term of this Lease, Landlord may assign the Security Deposit to the Transferee. Upon assumption by such Transferee of liability for the Security Deposit, Landlord will have no further liability for the return of the Security Deposit.

2. Letter of Credit<sup>33</sup>

- A. In lieu of providing the security deposit described in Section \_\_\_\_\_ in cash, Tenant may provide such security deposit in the form of a letter of credit, and if Tenant so elects, Tenant, contemporaneously with the execution of this Lease, must deliver to Landlord an unconditional irrevocable standby letter of credit in favor of Landlord (such letter of credit and any renewals, replacements, substitutes, amendments or endorsements thereto are herein referred to as the "LOC"), in the following amount and containing the following terms and provisions, and the LOC must otherwise be in form and content acceptable to Landlord:
1. The amount of the LOC must be in the amount of \$ \_\_\_\_\_;
  2. The LOC must be payable in the City of \_\_\_\_\_, \_\_\_\_\_;
  3. The LOC must be issued by a bank acceptable to Landlord;
  4. The LOC must be for an initial term of 12 months, and (except as otherwise provided in this section), must automatically renew without any action on the part of Landlord, for additional consecutive terms of 12 months;
  5. The LOC may contain a provision allowing the issuing bank to have the right to not renew the LOC for a renewal term, provided that the issuing bank provides written notice to Landlord no later than 60 days prior to the expiration of the LOC;
  6. The issuing bank will honor Landlord's draw request without any inquiry as to the accuracy thereof and regardless of whether Tenant disputes such draw.
  7. The LOC will allow partial draws and multiple draws up to the face amount of the LOC;

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<sup>33</sup> This letter of credit provision is intended to be used in conjunction with the typical security deposit provision of the lease. The security deposit provision will, among other things, describe the circumstances in which Landlord may resort to the security deposit, will state that the security deposit is not a measure of damages in the case of a tenant default and that Landlord is not making an "election of remedies" by accessing the security deposit, and will provide how Landlord handles the cash if the letter of credit is reduced to cash (e.g. interest thereon, return of funds to tenant). If this provision is not used in conjunction with another security deposit provision, then those same concepts should be incorporated into this language.

8. In the event of a transfer or mortgage of Landlord's interest in the Demised Premises, the issuing bank will allow Landlord to transfer or assign the LOC to Landlord's transferee or mortgagee and Tenant agrees that upon such transfer, Landlord will be released by Tenant from all liability therefor, or alternatively, if the issuer will not allow such transfer of the LOC, Tenant agrees to provide a replacement LOC for the benefit of Landlord's transferee or mortgagee complying with the terms hereof, and any fee in connection therewith shall be payable by Tenant.
- B. Tenant agrees with Landlord as follows with respect to the LOC:
1. Tenant will keep the LOC in full force and effect throughout the entire term of this Lease, and for a period ending no earlier than 60 days after the expiration of the term of this Lease. In the event that for any reason such LOC is not in full force and effect, Tenant will immediately provide Landlord with a replacement LOC in accordance with the terms hereof or other security acceptable to Landlord, in Landlord's sole discretion.
  2. Whenever Landlord makes a draw under the LOC, Tenant will immediately provide Landlord with an additional LOC or the issuing bank's endorsement to the LOC restoring the amount of the LOC to the original principal amount, or other security acceptable to Landlord (in Landlord's sole discretion), in an amount equal to the amount so drawn.
  3. Tenant covenants with Landlord that it will not mortgage, assign or encumber the LOC or any part thereof and that neither Landlord nor its successors or assigns will be bound by any such mortgage, assignment, encumbrance, attempted assignment or attempted encumbrance without Landlord's prior written consent.
  4. If Tenant does not provide Landlord with a replacement or renewal LOC, which is effective at least 30 days prior to the expiration of the then existing LOC, upon the terms and provisions hereof, without any notice to Tenant, Landlord may immediately draw the entire amount out of the LOC, to be held and applied by Landlord as the security deposit under this Lease.
  5. Tenant shall pay all fees and expenses in connection with obtaining, maintaining and renewing the letter of credit.

3. Lease Bond<sup>34,35</sup>

**Provision of Bond.** Contemporaneously with the execution of this Lease, Tenant agrees to provide to Landlord, an unconditional, irrevocable bond in the amount of \$ \_\_\_\_\_ (such bond and any renewal or replacement bond are referred to herein as the "Bond") in favor of Landlord, to secure the full and faithful performance by Tenant of all of its obligations under this Lease, in the form attached hereto as Exhibit " " which is incorporated herein by this reference or other form acceptable to Landlord, which Tenant agrees to maintain throughout the term of this Lease and for a period expiring 60 days after the expiration of the term of this Lease.

**Bond Issuer.** The issuer of the Bond must be acceptable to Landlord, in Landlord's sole and absolute discretion; such issuer shall in any event be rated no less than "A-VI" in the then most current issue of Best's Insurance Reports, or have no less than a comparable rating by an equivalent rating agency.

**Renewal/Replacement.** In the event that any Bond provided by Tenant pursuant to this section expires or is terminated prior to the date which is 60 days after the end of the term of this Lease, Tenant will immediately renew or replace the Bond at least thirty (30) days prior to the expiration or termination of the then existing Bond.

**Costs.** All costs of obtaining, maintaining, replacing, renewing, and/or restoring the Bond in accordance with this Section \_\_\_ shall be borne by Tenant.

**Draws Under the Lease Bond/Restoration.**

- (a) The Bond may be drawn upon at any time, and from time to time, in part or in full, upon presentation of only the Bond and a written statement from an authorized representative of Landlord stating (i) that Tenant is in default under the Lease, and (ii) the amount to be drawn.
- (b) If Landlord shall at any time draw upon the Bond in accordance with this Section \_\_\_, Tenant will restore all amounts drawn by Landlord within \_\_\_\_\_ days of such draw by providing an additional Bond, or other security acceptable to Landlord.
- (c) It shall be an Event of Default under this Lease if Tenant has not, within thirty (30) days prior to the expiration or termination of the Bond, delivered to Landlord

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<sup>34</sup> See generally, *Use 11 Lease Safeguards to Reduce Lease Bonds Risk*, Commercial Lease Law Insider, September 2000.

<sup>35</sup> This lease bond provision is intended to be used in conjunction with the typical security deposit provision of the lease. The security deposit provision will, among other things, describe the circumstances in which Landlord may resort to the security deposit, will state that the security deposit is not a measure of damages in the case of a tenant default and that Landlord is not making an "election of remedies" by accessing the security deposit, and will provide how Landlord handles the cash if the lease bond is reduced to cash (e.g. interest thereon, return of funds to tenant). If this provision is not used in conjunction with another security deposit provision, then those same concepts should be incorporated into this language.

a renewal or replacement Bond complying with all of the requirements of this Lease. In such event, Landlord shall be entitled, immediately, and without notice to Tenant, to draw the entire amount of the Bond, and such amount drawn shall be held by Landlord as the security deposit under this Lease.

- (d) Draws shall be payable to Landlord under the Bond, without inquiry by the Issuer as to the accuracy of Landlord's draw request and regardless of whether Tenant disputes the amount or validity thereof.
- (e) The proceeds of the Bond paid to Landlord upon presentment thereof constitute a part of the Security Deposit for use in the manner set forth in Section \_\_\_\_.

**Transfer.** In the event of a transfer or mortgage of Landlord's interest in the Demised Premises, the surety will allow Landlord to transfer the Bond to the transferee or assign the Bond to the mortgagee, or alternatively, if the surety will not allow such transfer or assignment, Tenant agrees to provide a replacement bond for the benefit of such transferee or assignee, and any fee in connection therewith shall be payable by Tenant.

**Cooperation by Tenant.** Tenant hereby agrees to cooperate with Landlord to promptly deliver to Landlord any and all modifications, amendments, and replacements of the Bond, as Landlord may reasonably request, in order to carry out the terms and conditions of this Section \_\_\_\_.

**EXHIBIT B****SAMPLE FORM OF LEASE GUARANTY**

In consideration of the making of that certain Lease Agreement (as same may be amended and/or renewed from time to time, the "Lease") dated \_\_\_\_\_, \_\_\_\_\_ and executed by and between \_\_\_\_\_, a \_\_\_\_\_ ("Landlord"), and \_\_\_\_\_, a \_\_\_\_\_ ("Tenant"), covering certain space designated as Suite No. \_\_\_\_\_ in the building currently known as " \_\_\_\_\_ " located at \_\_\_\_\_ in the City of \_\_\_\_\_, \_\_\_\_\_ County, Texas, and for the purpose of inducing Landlord to enter into and make the Lease, the undersigned (the "Guarantor", whether one or more than one) has guaranteed and by this instrument (the "Guaranty") hereby unconditionally guarantees the full and prompt payment of all Rent (as defined in the Lease), Additional Rent (as defined in the Lease) and all other sums required to be paid by Tenant under the Lease (including, without limitation, all rent payable with respect to the initial leased Premises and all expansion space) (individually, a "Guaranteed Payment", and collectively, the "Guaranteed Payments") and the full and faithful performance of all terms, conditions, covenants, obligations, liabilities, duties and agreements contained in the Lease on the Tenant's part to be performed (individually, a "Guaranteed Obligation", and collectively, the "Guaranteed Obligations") and the undersigned Guarantor further promises to pay all of Landlord's costs and expenses (including reasonable attorneys' fees) incurred in endeavoring to collect the Guaranteed Payments or to enforce the Guaranteed Obligations or otherwise incurred in enforcing this Guaranty, as well as any and all damages that Landlord may suffer in consequence of any default or breach under the Lease or this Guaranty.

1. Landlord may at any time and from time to time, without notice to or consent by the undersigned Guarantor, take any or all of the following actions without releasing, affecting, or impairing the liabilities and obligations of the undersigned Guarantor under this Guaranty:
  - (a) grant an extension or extensions of time for payment of any Guaranteed Payment or time for performance of any Guaranteed Obligation;
  - (a) grant an indulgence or indulgences in the payment of any Guaranteed Payment or in the performance of any Guaranteed Obligation;
  - (b) modify, amend, or change the Lease or any term thereof or any obligation of Tenant arising thereunder;
  - (c) consent to any assignment or assignments, sublease or subleases and successive assignments or subleases by Tenant or Tenant's successors or assigns;
  - (d) consent to an extension or extensions of the term of the Lease;
  - (e) accept other guarantees or guarantors; and/or

- (f) release any person primarily or secondarily liable hereunder or under the Lease or under any other guaranty of the Lease.
2. The liability of the undersigned Guarantor under this Guaranty shall not be affected, impaired, modified, changed, released or limited in any manner whatsoever by any failure or delay by Landlord in enforcing any Guaranteed Payment or Guaranteed Obligation or this Guaranty or any security therefor or in exercising any right or power in respect thereto, or by any compromise, waiver, settlement, change, subordination, impairment, release, modification or disposition of any Guaranteed Payment or Guaranteed Obligation or of any security therefor, and the liability of the Guarantor under this Guaranty shall not be impaired, modified, changed, released, or limited in any manner by any limitation of the liability of Tenant or its estate in bankruptcy, or of any remedy for the enforcement thereof, resulting from the operation of any present or future provisions of the United States Bankruptcy Code or any similar law or statute of the United States or any State thereof or from the decision of any court interpreting the same, or of any assumption or assignment or transfer of the Lease by Tenant or Tenant's bankruptcy trustee.
  3. In order to hold the undersigned Guarantor liable hereunder, there shall be no obligation on the part of Landlord, at any time, to resort to Tenant or to any other guaranty or to any security or other rights and remedies for payment or performance, and Landlord shall have the right to enforce this Guaranty irrespective of whether or not other proceedings or actions are pending or being taken seeking resort to or realization upon or from any of the foregoing.
  4. Guarantor waives all diligence in collection or in protection of any security, presentment, protest, demand, suit, notice of dishonor or default, notice of acceleration or intent to accelerate, notice of acceptance of this Guaranty, notice of any extensions granted or other action taken in reliance hereon and all demands and notices of any kind in connection with this Guaranty or any Guaranteed Payment or Guaranteed Obligation.
  5. Guarantor hereby acknowledges full and complete notice and knowledge of all the terms, conditions, covenants, obligations and agreements of the Lease.
  6. Guarantor expressly agrees (without in any way limiting its liability under any other provision of this Guaranty) that Guarantor will, at the request of Landlord, enter into a new lease with Landlord on terms and conditions as contained in the Lease immediately prior to its termination, for a term commencing on the termination date of the Lease and ending on the expiration date of the Lease, if the Lease shall be terminated due to a default by Tenant thereunder.
  7. If the Lease is modified in any respect by agreement between Landlord and Tenant, the obligations hereunder of Guarantor shall extend and apply with respect to the full and faithful performance and observance of all of the covenants, terms and conditions of the Lease and of any such modification thereof and Guarantor hereby consents to, and agrees to be bound by the terms of, such modification. If the Lease is renewed or extended for any period beyond the date specified in the Lease for the expiration of said term, either



pursuant to any option granted under the Lease or otherwise, or if the Tenant holds over beyond the term of the Lease, the obligations hereunder of Guarantor shall extend and apply with respect to the full and faithful performance and observance of all of the terms, conditions, covenants, obligations, liabilities, duties and agreements contained in the Lease (or any modification of the Lease).

8. The payment by the undersigned Guarantor of any amount pursuant to this Guaranty shall not in any way entitle the undersigned Guarantor to any right, title or interest (whether by subrogation or otherwise) of Tenant under the Lease or to any security being held for any Guaranteed Payment or Guaranteed Obligation.
9. This Guaranty shall be continuing, absolute and unconditional and shall remain in full force and effect until all Guaranteed Payments are made, all Guaranteed Obligations are performed and all obligations of the undersigned Guarantor under this Guaranty are fulfilled. Insofar as the payment by Tenant of any sums of money to Landlord is involved, this Guaranty is a guaranty of payment and performance and not of collection and will remain in full force and effect until payment in full to Landlord of all sums payable under the Lease. Guarantor waives any right to require that any action be brought against Tenant.
10. This Guaranty, and all of the terms hereof, shall be binding on Guarantor and the heirs, personal representatives, successors, assigns, and legal representatives of the undersigned Guarantor and shall inure to the benefit of Landlord and Landlord's successors and assigns.
11. This Guaranty is governed by and shall be construed according to the laws of the State of Texas and shall be performed in the county identified in the first paragraph of this Guaranty. The situs for the resolution (including any judicial proceedings) of any disputes arising under or relating to this Guaranty shall be the county referenced in the first paragraph of this Guaranty. Guarantor hereby consents to the jurisdiction of any competent court within said county. Guarantor hereby waives trial by jury in any action brought on or with respect to this Guaranty. Guarantor hereby waives the benefit of any statute of limitations affecting Guarantor's liability under this Guaranty.
12. If this Guaranty is executed by more than one person, all singular nouns and verbs herein relating to the undersigned Guarantor shall include the plural number. The obligations of Tenant and all guarantors shall be joint and several and Landlord may enforce this Guaranty against any one or more of Tenant and any guarantor without joinder of Tenant or any other guarantor (hereunder or otherwise).
13. Guarantor hereby appoints Tenant as its lawful agent authorized to receive service of process on behalf of Guarantor.
14. Every year throughout the Lease term on the first day of each January, Guarantor shall deliver to Landlord current, complete, accurate, and detailed audited financial statements of Guarantor, current bank references for Guarantor, and a Dun & Bradstreet report on Guarantor, if available.

15. Landlord and the undersigned Guarantor intend and believe that each provision of this Guaranty comports with all applicable law. However, if any provision of this Guaranty is found by a court of competent jurisdiction to be invalid for any reason, the remainder of this Guaranty shall continue in full force and effect and the invalid provision shall be construed as if it were not contained herein.
16. Other agreements similar to this Guaranty may, at Landlord's sole option and discretion, be executed by other persons with respect to the Lease. This Guaranty shall be cumulative of any such agreements and the liabilities and obligations of the undersigned Guarantor under this Guaranty shall not be affected or diminished by reason of any such other agreements. Moreover, if Landlord obtains another signature of more than one guarantor on this Guaranty or by obtaining additional guaranty agreements, or both, Guarantor agrees that Landlord, in Landlord's sole discretion, may (a) bring suit against all Guarantors of the Lease, jointly and severally, or against any one or more of them, (b) compound or settle with any one or more of the guarantors for such consideration as Landlord may deem proper, and (c) release one more of the guarantors from liability. No such action shall impair the rights of Landlord to enforce the Lease or any guaranty obligations against any remaining guarantor or guarantors, including the undersigned Guarantor.
17. Guarantor is not entitled to:
  - (i) exercise or enforce (a) any rights it may have as a creditor of Tenant or (b) any rights of subrogation it may have against Tenant;
  - (ii) take steps or institute any action or proceedings (judicial or otherwise) to enforce any liens, collateral rights, judgments or other encumbrances held by Guarantor on assets of Tenant; or
  - (iii) otherwise be entitled to enforce or receive payment, directly or indirectly, of any amounts owed by Tenant or Guarantor,

until all of the Guaranteed Payments have been fully and finally paid and all of the Guaranteed Obligations have been fully and finally satisfied and performed.

18. **[Delete for individual Guarantor]** If Guarantor is a corporation or a partnership (general or limited), each person signing this Guaranty as an officer or a partner of Guarantor represents to Landlord that such person is authorized to execute this Guaranty without the necessity of obtaining any other signature of any other officer or partner, that the execution of this Guaranty has been authorized by the board of directors of the corporation or by the partners of the partnership, as the case may be, and that this Guaranty is fully binding on the undersigned Guarantor and has been determined by the board of directors of the corporation or by the partners of the partnership, as the case may be, to reasonably be expected to benefit such corporation or partnership.

**[The remainder of this page intentionally left blank.]**

IN WITNESS WHEREOF, the undersigned Guarantor has executed and delivered this Guaranty on the date(s) set forth beneath the signature(s) below, to be effective as of the effective date of the Lease.

**GUARANTOR :**

**[If an individual guarantor]**

Address:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Social Security No.: \_\_\_\_\_  
Driver's License No.: \_\_\_\_\_  
State: \_\_\_\_\_  
Date of Execution: \_\_\_\_\_

**[If a corporate guarantor or other entity]**

Address:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_  
a \_\_\_\_\_

By: \_\_\_\_\_  
Printed Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
Tax I.D. No.: \_\_\_\_\_  
Date of Execution: \_\_\_\_\_

**EXHIBIT C**

**SAMPLE FORM OF LETTER OF CREDIT**

[LETTERHEAD OF BANK]

LETTER OF CREDIT NO. \_\_\_\_\_

DATE: \_\_\_\_\_, 200\_

FOR THE ACCOUNT OF: \_\_\_\_\_

TO BENEFICIARY: \_\_\_\_\_

BENEFICIARY'S ADDRESS: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

AMOUNT: \$ \_\_\_\_\_

EXPIRATION DATE OF INITIAL TERM: \_\_\_\_\_, 200\_

Gentlemen:

**[insert name of bank]** ("Issuer"), hereby issues to you its Irrevocable, Unconditional Standby Letter of Credit for the account of **[insert name of tenant]** (the "Applicant") in the amount of U.S. \$ \_\_\_\_\_ Dollars (\$ \_\_\_\_\_) available by your draft at sight on us. Partial drawings are permitted hereunder at any time and from time to time.

Drafts drawn on this Letter of Credit will be honored when presented by you when accompanied by this Letter of Credit, together with your drawing certificate in the form attached hereto as Annex "A," containing the statement set forth on such drawing certificate, drawn on us, bearing the clause: "Drawn under \_\_\_\_\_ Irrevocable Standby Letter of Credit No. \_\_\_\_\_ for the account of \_\_\_\_\_." Payment will be made hereunder not later than 3:00 p.m., [city, state] time on the same Business Day as the date such demand for payment is presented as aforesaid, without inquiry and regardless of whether Applicant disputes the draw request, so long as such demand conforms with the foregoing and is received before 10:00 a.m. [city, state] time. If such demand conforms with the foregoing but is received after 10:00 a.m. [city, state] time, payment hereunder will be made without inquiry and regardless of whether Applicant disputes the draw request not later than 3:00 p.m. [city, state] time on the Business Day after such demand is received or such later day as you may specify. Payment of any amount drawn under this Letter of Credit will be made in immediately available funds by wire transfer to such account as you shall specify or in such other manner as you may from time to time specify

by written notice to us. For purposes of this Letter of Credit, the term "Business Day" shall mean a day upon which banks in [city, state] are open for commercial business.

This Letter of Credit is subject to the Uniform Customs and Practice for Documentary Credits (1993 Revision), International Chamber of Commerce Publication No. 500 (the "UCP"). This Letter of Credit shall also be deemed to be subject to the laws of the State of \_\_\_\_\_ and shall, as to matters not covered by the UCP, be governed by and construed in accordance with the laws of said state.

This Letter of Credit is transferable and assignable in its entirety and may be successively transferred and assigned, without any cost or fee, upon Issuer's receipt of written notice of such transfer or assignment. Transfer of the available balance under this Letter of Credit shall be effected by the presentation to us of this Letter of Credit accompanied by instructions from you indicating your transfer of the Letter of Credit. Upon such presentation we shall forthwith transfer the same to your transferee, or if so requested by your transferee, issue a letter of credit to your transferee with provisions therein consistent with this Letter of Credit. We agree to execute a consent to an assignment by you of this Letter of Credit.

This Letter of Credit shall be deemed automatically extended for additional successive one (1) year periods unless Issuer notifies Beneficiary by certified mail, return receipt requested, at Beneficiary's address set forth above, at least thirty (30) days prior to the expiration date of this LOC that Issuer will not renew this Letter of Credit, in which event this Letter of Credit shall expire at the end of such one (1) year term.

This Letter of Credit sets forth in full our undertaking, and such undertaking shall not in any way be modified, amended, amplified, or limited by reference to any document, instrument, or agreement referred to herein or in which this Letter of Credit is referred to or to which this Letter of Credit relates, and any such reference shall not be deemed to incorporate herein by reference any document, instrument, or agreement.

All bank charges in connection with this Letter of Credit are for the account of the Applicant.

Very truly yours,

\_\_\_\_\_

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

ANNEX "A"

Drawing Certificate

Drawn Under Bank \_\_\_\_\_ Irrevocable Standby Letter of Credit No. \_\_\_\_\_  
For the Account of \_\_\_\_\_

Date: \_\_\_\_\_

To: \_\_\_\_\_  
\_\_\_\_\_

Attn: Letters of Credit Department

Drawing Information:

Amount: U.S. \$ \_\_\_\_\_

Payment Instructions:

Wire Funds to: \_\_\_\_\_

ABA No. \_\_\_\_\_

Reference \_\_\_\_\_

Attn: \_\_\_\_\_

\_\_\_\_\_ ("Beneficiary") hereby certifies that:

this draw covers amounts payable to Beneficiary as a result of a default by Applicant under its lease with Beneficiary.

In witness whereof, the undersigned has executed this drawing certificate on this \_\_\_\_ day of \_\_\_\_, \_\_\_\_.

\_\_\_\_\_

By: \_\_\_\_\_  
Authorized Officer

**EXHIBIT D****SAMPLE FORM OF LEASE BOND**

**KNOW ALL MEN BY THESE PRESENTS**, that \_\_\_\_\_ (hereinafter called the "**Principal**"), as Principal, and \_\_\_\_\_, a corporation duly organized under the laws of the State of \_\_\_\_\_ (hereinafter called the "**Surety**"), as Surety, are held and firmly bound unto \_\_\_\_\_ (hereinafter called the "**Obligee**"), as Obligee, in the initial sum of \_\_\_\_\_ Dollars (\$ \_\_\_\_\_), for the payment of which sum well and truly to be made, we the said Principal and the said Surety, bind ourselves, our heirs, executors, administrator, successors and assigns, jointly and severally, firmly by this Guaranty Bond for Lease Security Deposit ("**Bond**").

**WHEREAS**, Principal and Obligee have entered into that certain Lease Agreement (the "**Lease**" which is hereby referenced and made a part hereof for all purposes), dated as of \_\_\_\_\_, \_\_\_\_\_, and in consideration of the rents, obligations, covenants, and agreements contained therein, to be paid and performed by Principal, Obligee has leased to Principal that certain premises located at \_\_\_\_\_ and more specifically described in the Lease; and

**WHEREAS**, pursuant to the Lease, Principal has agreed to provide a bond to secure the performance of certain obligations of Principal under the Lease.

**NOW, THEREFORE**, the condition is such that if the Principal shall well and truly keep all the terms and conditions as outlined in said Lease then this obligation shall be null and void, otherwise to remain in full force and effect.

**PROVIDED, HOWEVER**, this Bond is executed by the Surety and accepted by the Obligee subject to the following conditions:

A. Obligee may transfer or assign its rights as Obligee under this Bond to any successor landlord under the Lease or mortgagee of the premises leased, without any cost or fee. Obligee agrees to give Surety written notice of any such assignment.

B. This obligation may be terminated by the Surety upon sixty (60) days prior written notice to Obligee, such notice to be sent by certified mail, return receipt requested to Obligee at \_\_\_\_\_, but in no event may Surety terminate this Bond on or before \_\_\_\_\_, 20\_\_\_. Such termination shall not affect liability incurred under this Bond prior to the effective date of such termination.

C. It shall be a condition precedent to any right of recovery under this Bond that, in the event of any default under the Lease on the part of the Principal, a written statement certifying that Principal is in default shall be given by the Obligee to the Surety along with a draw request stating the amount Obligee is drawing under this Bond. The Surety will be unconditionally obligated to honor the draw request, without inquiry and regardless of whether Principal disputes the draw request, on or before fifteen (15) days after Surety's receipt of such statement.

D. No action, suit or proceeding shall be had or maintained, against Surety on this Bond unless the same be brought or instituted within one hundred twenty (120) days after the termination or release of this Bond. In the event Surety refuses to unconditionally honor a draw request by Obligee in accordance with the terms of this Bond, then Obligee may recover from Surety all attorneys' fees and other costs incurred in pursuit of such claim, whether or not legal action is commenced, and whether or not such legal action is pursued to judgment.

E. Under no circumstances shall the aggregate liability of the Surety exceed the penal sum above stated.

F. Partial drawings are permitted under this Bond at any time, and from time to time.

G. This Bond shall be effective from \_\_\_\_\_, \_\_\_\_\_, to \_\_\_\_\_, subject to the provisions of paragraph B above.

H. All charges in connection with this Bond are payable by Principal.

IN WITNESS WHEREOF, the Principal and Surety have caused this Bond to be executed as of this \_\_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.

PRINCIPAL:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

SURETY:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_



**EXHIBIT E****LANDLORD'S LIEN<sup>36</sup>**

In addition to any statutory landlord's lien, Landlord shall have at all times a valid security interest to secure payment of all Rent and other sums of money becoming due hereunder from Tenant, and to secure payment of any damages or loss which Landlord may suffer by reason of the breach by Tenant of any covenant, agreement or condition contained herein, upon all goods, wares, equipment, fixtures (including trade fixtures), furniture, improvements and other personal property of Tenant presently, or which may hereafter be, situated in the Premises, and all proceeds from the sale or lease thereof, and such property shall not be removed therefrom without the prior written consent of Landlord (except for sales to Tenant's customers in the ordinary course of business) until all arrearages in Rent, as well as any and all other sums of money then due to Landlord hereunder, shall first have been paid and discharged and all the covenants, agreements and conditions hereof have been fully complied with and performed by Tenant. Upon the occurrence of an Event of Default by Tenant, Landlord may, in addition to any other remedies provided herein or by law, enter upon the Premises and take possession of any and all goods, wares, equipment, fixtures, furniture, improvements and other personal property of Tenant situated in the Premises, without liability for trespass or conversion, and sell the same at private or public sale, with or without having such property at the sale, after giving Tenant reasonable notice of the time and place of any public sale or of the time after which any private sale is to be made. Unless otherwise required by law, and without intending to exclude any other manner of giving Tenant reasonable notice, the requirement of reasonable notice to Tenant of a private or public sale shall be met if such notice is given in the manner prescribed in Section of this Lease at least ten (10) days before the date of sale, Tenant agreeing that such notice affords Tenant sufficient opportunity prior to sale to obtain a hearing if desired by Tenant. Any public sale made under this Section shall be deemed to have been conducted in a commercially reasonable manner if held in the Premises or where the property is located, after the time, place and method of sale and a general description of the types of property to be sold have been advertised in a daily newspaper published in the county in which the Premises are located, for five (5) consecutive days before the date of the sale. Landlord or its assigns may purchase at a public sale and, unless prohibited by law, at a private sale. The proceeds from any disposition dealt with in this Section, less any and all expenses connected with the taking of possession, holding and selling of the property (including reasonable attorneys' fees and legal expenses) shall be applied as a credit against the indebtedness secured by the security interest granted in this Section. Any surplus shall be paid to Tenant or as otherwise required by law. Tenant shall pay any deficiencies on demand. Upon request by Landlord, Tenant shall execute and deliver to Landlord a financing statement in form sufficient to perfect the security interest of Landlord in the aforementioned property and proceeds thereof under the provisions of the Uniform Commercial Code in force in the state in which the Premises are located, or if allowed by law, Landlord may file a financing statement signed by Landlord, without Tenant's signature, to which Tenant hereby expressly consents and Tenant hereby appoints Landlord as its attorney-in-fact to sign such financing statement on behalf of Tenant. Additionally, Tenant agrees that a photocopy of this Section and the signature page of this Lease shall be sufficient to

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<sup>36</sup> Be advised that state laws differ on this matter.

constitute a financing statement. Any statutory lien for rent is not hereby waived, the security interest herein granted being in addition and supplementary thereto.