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North Carolina Court of Appeals Issues Important Opinion on Commercial Lease Guaranties

Christian H. Staples, Associate | cstaples@slk-law.com | 704.945.2183

Is a personal guaranty a separate agreement from the underlying contract it guarantees? The North Carolina Court of Appeals recently considered this issue in *Friday Investments, LLC v. Bally Total Fitness of the Mid-Atlantic, Inc.*, 2017 WL 3254773 (N.C. Ct. App., Aug. 1, 2017). The case was decided by a 2-1 decision, with Judge Tyson delivering the opinion of the Court and Judge Elmore dissenting by a separate opinion. Further appeal to the Supreme Court of North Carolina is pending with oral argument scheduled for later this month, so this is surely a case to monitor over the next few months.

The *Bally* case arose from a lease of commercial property by Friday Investments, as landlord and successor-in-interest to the original landlord, to Bally of the Mid-Atlantic, as tenant as successor-in-interest to the original tenant. Bally Holding, a separate but affiliated corporate entity, guaranteed the obligations of the original tenant and tenant's successors-in-interest under the lease. When Bally of the Mid-Atlantic defaulted on its monthly rent obligations, Friday Investments sued to recover damages jointly and severally from the tenant and the guarantor. Shortly thereafter, Friday Investments moved for summary judgment against both defendants on its breach of contract claim.

The trial court granted summary judgment against the tenant, Bally of the Mid-Atlantic, concluding that it had breached the terms of the lease but reserving the issue of damages for trial. Complicating matters with respect to the guarantor's liability, however, were prior bankruptcy proceedings involving both defendants, amendments to the lease, and an estoppel certificate executed by a corporate officer for both the tenant and the guarantor. Based on its review of the foregoing, the trial court ultimately granted summary judgment in *favor of the guarantor*. In so doing, the trial court characterized the lease and guaranty as separate agreements and concluded that while the lease had been assumed in the bankruptcy proceedings, the guaranty had been discharged by the terms of the plan of reorganization previously approved by the bankruptcy court. The trial court certified its order for immediate appellate review.

The Court of Appeals reversed the trial court, finding that genuine issues of material fact precluded entry of summary judgment in favor of the guarantor, and remanded the case for trial. In its written majority opinion, the Court of Appeals first considered whether the lease and guaranty were separate agreements or a single executory contract. This is the critical issue raised in *Bally* because its resolution could have a wide-ranging impact on the way contracts and guaranties are drafted and executed in North Carolina.

The *Bally* court concluded, as the trial court before it had, that the guaranty at issue was a wholly independent and separate contract, capable of being discharged in bankruptcy even if the underlying lease was assumed. The Court of Appeals explained that a guarantor makes his own separate contract and is not bound to do what his principal has contracted to do, except insofar as he has bound himself by his separate contract. Furthermore, the strict independence of the two agreements is not affected by the fact that both are written on the same instrument or contemporaneously executed, or that one is incorporated by reference in or attached as an exhibit to the other.

Nevertheless, the *Bally* court found that certain language contained in the bankruptcy court filings and in an amendment to the lease raised genuine issues of material fact on whether the guaranty was "required to be maintained" or was discharged in bankruptcy, thereby precluding summary judgment in favor of either the landlord or the guarantor.

Of note, the original guaranty provided in pertinent part as follows:

> … the undersigned guarantees the full performance and observance of all the covenants, conditions and agreements contained in the Lease to be performed and observed by Tenant, Tenant's successors and assigns…. The undersigned further covenants and agrees that this Guaranty shall remain and continue in full force and effect as to any renewal, modification, or extension of said Lease…. It is further agreed that all of the terms and provisions hereof shall inure to the benefit of the successors and assigns of Landlord, and shall be binding upon the successors and assigns of the undersigned.

Based upon this language, amendments or extensions to the lease should not affect or release the responsibilities of the guarantor, and the guaranty should remain in effect and enforceable by any successors-in-interest or assigns. It is therefore somewhat curious that the majority opinion did not conclude that summary judgment should have been granted in favor of the landlord and against the guarantor, since it appears the guaranty was "required to be maintained." Judge Elmore stated in his dissenting opinion that he would have so held.

In reaching this contrary conclusion, Judge Elmore argued in his dissenting opinion that the parties expressed a clear intent to treat the lease and guaranty as component parts of a single executory contract, which had to be either assumed or discharged in its entirety during the bankruptcy proceedings. According to Judge Elmore, this intent was evidenced by Bally Holding's execution of the guaranty contemporaneously with, if not prior to, the lease as an "inducement" to the landlord. Moreover, the guaranty, attached as an exhibit to the lease, is explicitly referenced in the recitals as follows: "WHEREAS, the performance of the obligations of Tenant under this Lease is to be guaranteed by [the predecessor-in-interest to Bally Holding] pursuant to a Guaranty in the form of Exhibit C attached hereto." The guaranty, likewise, references the lease and the liability of Bally Holding thereunder as follows: "Whatever reference is made to the liability of Tenant with the Lease, such reference shall be deemed likewise to refer to the Guarantor." In addition to the cross-references contained in the documents, the lease expressly incorporates the guaranty. Article 1.1 provides: "[T]he recitals, as well as the exhibits attached to this Lease, are hereby incorporated into this Lease in their entirety." In sum, the dissent argues that judicial treatment of a guaranty "should not be so rigid to preclude the parties from drafting toward more suitable arrangements."

As indicated by the facts in *Bally*, there may be certain advantages to treating a lease and guaranty as a single executory contract, but under current North Carolina law such treatment is not the presumption. Unfortunately it remains to be seen whether a lease and guaranty can ever be treated as a single contract in North Carolina. Given the sharp contrast of opinion expressed by the panel of judges on the Court of Appeals, expect the Supreme Court of North Carolina to speak on this issue in the near future. The issues raised in *Bally* could have wide-ranging impact on a variety of contracts and guaranties, far beyond the realm of commercial leasing.

Christian Staples is an attorney in the firm's Charlotte, NC office. He regularly represents commercial property owners and landlords in commercial leasing matters, including summary ejectment proceedings and actions to collect money damages. He can be reached at cstaples@slk-law.com.