Personal guarantees in commercial leases

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The recent High Court judgment *Kung v DVD Advance Limited*[1] explores a dispute over unpaid rent and outgoings. It is particularly interesting, however, in its consideration of the enforceability of guarantees in commercial leases where a formal deed has not been executed. This case highlights the special care required when acting for a landlord, to ensure any personal guarantees are enforceable.

Background

By agreement to lease dated 18 November 2013, Ms Kung ('Kung') agreed to grant, and DVD Advance Limited ('DVD'), agreed to take a lease of Kung's Dunedin property for DVD's rental business. The agreement was on the then current Auckland District Law Society Inc ('ADLS') agreement to lease form. Kung signed the agreement as landlord and Mr Ferguson ('Ferguson'), the sole director of DVD, signed on behalf of DVD as tenant.

That form of the ADLS agreement to lease did not contain a space for the name of a guarantor so Ferguson had handwritten "Gauranteed (sic) by DANIEL FERGUSON", and signed next to it.

There were two clauses in the agreement to lease that were relevant to the issues in this case:

- Clause 4 stated that the tenant shall enter into a formal lease with the landlord on covenants no more onerous than those contained in the *Auckland District Law Society* Commercial Lease Form 3rd Edition 1993.
- Clause 6 stated that where the tenant is a company, and if the landlord requires, the tenant shall arrange for its shareholders to guarantee the obligations of the tenant. Notably, clause 6 was the only reference to a guarantee in the agreement besides the handwritten addition of Ferguson.

Kung's solicitors prepared a formal Deed of Lease on the Sixth Edition 2012 of the ADLS deed of lease form, including provision for Ferguson to enter into it as guarantor and the usual guarantee provisions. They submitted the lease to Ferguson's solicitor but the deed of lease was never signed.

By late 2015, DVD fell into arrears for unpaid rent and outgoings. DVD accepted liability for these sums up to 23 May 2016, at which time a flood caused by a blocked drain rendered the premises uninhabitable and DVD contended that the lease had terminated accordingly. Ferguson denied liability altogether.

The issues

The issues before the Court to be decided were:

- Whether DVD was liable for rent outgoings and interest from 23 May 2016 to 2 December 2016.
- Whether Ferguson was a guarantor of the liability of DVD for the unpaid sums.

Was DVD liable for unpaid sums after 23 May 2016?

Ferguson claimed that, from the outset, Kung was aware that DVD rental businesses were in decline. He said in late 2015 he rang Kung and they discussed the fact that DVD might be unable to meet its obligations under the agreement to lease. Ferguson claimed that he expressed the possibility of DVD selling its assets and closing late December 2015. Ferguson claimed that Kung then suggested they work together to find a new tenant. Then, on 23 May 2016 DVD's sales were halted by a flood that rendered the premises untenantable. Ferguson claimed that at this point he and Kung agreed the store should close. Critically, he contended that at this point both parties agreed that neither DVD nor Ferguson himself would be liable for any rent or outgoings beyond the closure date.

Kung ardently denied this contention. She claimed that there was never any suggestion (no discussion, and most certainly no agreement) that neither DVD nor Ferguson would be liable for the unpaid sums beyond the closure date. She claimed that the first she had heard of such an idea was in Ferguson's affidavit.

The Court quickly decided this was not an issue which could be resolved on affidavit evidence. Summary judgment on this issue was denied; the issue was deferred for resolution at trial.

Was Ferguson liable as a guarantor?

With respect to the second issue, counsel for Kung presented two lines of argument.

The first was that there was an obligation on Ferguson to execute the formal guarantee contained in the Deed of Lease submitted to his solicitors. Following the principle that equity regards as having been done that which should have been done, Kung contended that Ferguson was liable as guarantor under this formal Deed of Lease, despite this document never being executed.

The second, alternative, argument was more straightforward: that Ferguson was liable as a guarantor of the terms contained in the agreement to lease, because he signed that document as such.

Ferguson countered on several fronts.

He claimed that the Court could not entertain arguments relying on the Deed of Lease as founding liability, as these were not pleaded. Ferguson also stated that he could not be liable as a guarantor as clause 6 of the agreement stated the shareholders (plural) must guarantee the obligations. As Ferguson was not the only shareholder of DVD, on the principle found in *Kolmar Investments Ltd v R Hannah &*

Co Ltd Ferguson could not be bound until all shareholders had signed a guarantee document.[2] Finally, Ferguson claimed that section 27 of the Property Law Act 2007–which requires contracts of guarantee to be in writing and signed–was not satisfied.

Was Ferguson liable as a guarantor on terms in the unsigned Deed of Lease?

The Court's decision on this point followed the *Honk Land Limited v Featherston* line of cases, discussing both the High Court appeal,[3] and the subsequent application for leave to appeal to the Court of Appeal.[4]

The Honk Land case involved strikingly similar facts: a handwritten personal guarantee added to a standard form agreement to lease, and no formal deed of lease executed. The appellant in that case similarly sought to rely on clause 4 to enforce the equitable lease and therefore enforce the guarantee for the full duration of that equitable lease.

Both the appeal and the application for leave to appeal were dismissed on the basis of uncertainty. The terms of the formal deed to be subsequently executed were not certain enough–all that was certain was that the terms would not be *more onerous* than those in the ADLS standard form lease. It was entirely possible that these terms could be considerably *less onerous*–hence the uncertainty. As a result, the principle of *Walsh v Lonsdale* for enforcing equitable leases could not be applied.[5]

The Court considered, therefore, that Kung's first line of argument must fail.

Was Ferguson liable as a guarantor on the terms of the Agreement to Lease?

The Court noted that in Kung's second line of argument she relied expressly on the terms of the agreement to lease.

To counter this claim, Ferguson had relied on *Regan v Brougham*.[6] In that case a signed guarantee was invalid because the document–the ADLS term loan agreement form–contained a condition precedent that a formal deed of guarantee must be signed. The Court distinguished this case as being one where the guarantee was accompanied by words of limitation, thus rendering it invalid in the absence of the required formal guarantee.

The Court considered *Bradley West Solicitors Nominee Company Ltd v Keeman*.[7] In that case was a variation of mortgage document signed by four persons next to the word "Guarantors", and in that document was a clause saying those persons had executed the document as guarantors. In that case Tipping J stated that the question is whether the document itself evidences, with sufficient certainty, an intention to guarantee.

Turning once again to *Honk Land*–which, recall, had strikingly similar facts to this case–the Court noted that in that case both the District Court and High Court were happy to enforce the guarantee on the terms of the signed agreement to lease.

The reliance solely on the terms of the agreement to lease by Kung proved fatal to Ferguson's defence. The Court held that in the absence of a reliance on clause 6, which refers to 'shareholders of DVD', the principle in *Kolmar Investments* did not apply. That is, it was immaterial that not all shareholders of DVD had guaranteed its obligations. The Court held that the fact that Ferguson had written 'Gauranteed (sic) by DANIEL FERGUSON' on the agreement to lease, and signed, evidenced a sufficiently clear intention to guarantee the obligations of DVD. Further, as this was signed by Ferguson and the terms were recorded in writing in the agreement to lease, the guarantee complied with s 27 of the Property Law Act.

It followed that Kung had successfully established that Ferguson had no defence to her claim against him as guarantor under the agreement to lease for rent, outgoings and interest as set out in that agreement.

> "...a reminder of the importance of getting the formal deed of lease executed by all parties as soon as possible...

Commentary

The latest version of the ADLS agreement now contains operative guarantee provisions and provides for the guarantor to sign as a party. Those operative provisions include an obligation to sign the lease as guarantor. Further, that version of the agreement provides certainty as to the form of the lease i.e. the current ADLS form amended in accordance with the terms of the agreement. An agreement which references a form of lease 'no more onerous than' those contained in the ADLS form does not provide such certainty.

Consequently, the guarantee issues encountered in *Kung v DVD Advance Limited* are unlikely to arise if using the latest form of ADLS agreement to lease. However, in the myriad of forms that an agreement to lease can take, there are those that lack requisite certainty to ensure the intended guarantors are bound. Note that, even if a guarantor has signed the agreement to lease, if the form of the proposed deed of lease is left uncertain, the guarantor may be liable for the obligations set out in the agreement to lease (such as payment of rent for the term) but not any additional obligations as may be set out in the deed of lease (such as liability during a holding over period, repair and maintenance and reinstatement obligations, to name a few). This case is also a reminder of the importance of getting the formal deed of lease executed by all parties as soon as possible, ideally before the lease commences and certainly before tenancy defaults start to surface. ■

1. Kung v DVD Advance [2018] NZHC 3319.
2. Kolmar Investments Ltd v R Hannah & Co HC Auckland CIV-2002-404-1861, 5 June 2003.
3. Honk Land Ltd v Featherston (2006) 7 NZCPR 805 (HC).
4. Honk Land Ltd v Featherston HC Auckland (2007) AP-2005-404-7019, 30 April 2007.
5. Walsh v Lonsdale [1882] 21 ChD 9.
6. Regan v Brougham [2017] NZHC 1091.
7. Bradley West Solicitors Nominee Company Ltd v Keeman [1994] 2 NZLR 111.

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