

Default of Lease Contract

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It is important to have language in the lease as clear as possible to avoid problems such as unnecessary defaults.

A. Tenant Default and Landlord Remedies

A tenant defaults when it fails or is unable to perform one of its conditions or provisions in the lease. Not all lease covenants are created equal. Some provisions of a lease are more important than others, and so some breaches are more serious than others. Non-material breaches do not allow a landlord to evict a tenant. In order to clarify each party's understanding of what constitutes a breach of the lease, the parties may specify remedies for particular provisions when drafting the lease.

A tenant's rights are not automatically terminated upon default, as mentioned previously. When a tenant defaults the landlord can declare forfeiture, or the tenant's loss of right to the premises. Declaring forfeiture is considered a right of the landlord's and the landlord does not have to declare it. Forfeiture comes into effect when the landlord declares it and not when the tenant defaults, even if the lease provides automatic forfeiture upon tenant default.

The most common default is the failure to pay rent. If a tenant defaults, there are certain courses of action a landlord may pursue to remedy the default. The landlord may terminate the lease, re-enter and retake possession. The lease must have specific provisions authorizing these remedies for a landlord to pursue them. Nearly every lease contains provisions that allow for the landlord's right of re-entry upon the tenant's breach of a covenant. The provisions should also outline the landlord's right to damages if the landlord hopes to receive any.

Many leases require the landlord to give notice of the default and give the tenant opportunity to cure it before the tenant is actually in default. Notice specifically for rent due is not normally included in leases. Most landlords are not required in leases to send a notice before rent is due. However, many landlords do send notices, especially in leases with large rent amounts.

The method of notice for default should be clear to both parties at the beginning of the lease. This includes identifying the delivery method and who the notice will be given to. This will avoid misunderstandings and accidental claims. (A sample notice clause is given under the *Termination Rights Section*)

After notice is given, the party in default is usually given a grace period to cure the default before any actions against the breaching party are taken. Grace periods following defaults can vary. A tenant will want the grace period to begin after written notice of the default as opposed to right after the occurrence of the default. Most landlords will not necessarily have a problem with this, although they may worry about repeated defaults.

As mentioned previously, if a tenant defaults but the landlord continues to accept rent, the landlord waives its right to terminate the lease or seek remedies. The landlord must usually accept the late payments repeatedly before the landlord is considered to have waived the default. A landlord can avoid a waiver with a non-waiver provision in the lease. The provision should stipulate that acceptance of rent with knowledge of default does not constitute a waiver. If a landlord is unsatisfied with the default and decides to file an action for eviction, then the landlord should not accept anything less than full payment unless the parties sign a settlement agreement.

If the tenant has abandoned the premises the landlord may leave the premises vacant and sue to collect rent. In some cases the lease will permit the landlord to accelerate rent. In the case of abandonment, a landlord has no duty to mitigate damages unless there is a specific provision in the lease that states otherwise. In defense of abandonment, a tenant may claim a landlord has accepted the tenant's surrender. The landlord should deny acceptance of surrender if one is proffered. By accepting a surrender the tenant is released from further liability for unpaid rent and the landlord has a duty to mitigate damages. A formal acceptance usually requires an actual agreement or affirmative action by the landlord. The tenant cannot simply inform the landlord of its intent to move out to qualify as acceptance. Minnesota Statute § 513.04 states acceptance must be in a written agreement. However, courts have often found a landlord's actions to constitute acceptance. This type of acceptance is usually done by advertising for a new tenant, collecting rent from a new tenant or retaking possession.

Once a tenant has defaulted, a landlord can bring an eviction claim to ensure the tenant will leave. Before bringing an eviction claim the landlord should review the lease for notice and grace period requirements. Eviction claims are generally for possession of the premises only. The landlord will normally need to bring a separate claim to recover unpaid rent and damages. Evictions are most commonly used when the default involves unpaid rent or when the tenant continues to occupy the premises after the lease expires.

When bringing an eviction claim, a landlord can seek to terminate the tenant's right to possession or terminate the lease. By terminating the lease, the landlord can try to relet the premises and sue the tenant for rent. When determining whether to terminate the lease or to terminate the right to possession the landlord will want to consider the

solvency of the tenant, the chance of bankruptcy, and the likelihood of reletting the premises quickly. If the tenant is insolvent it might be better for the landlord to terminate the lease, since there will be less possibility of recovering rent and the landlord can relet the premises quickly. Alternatively, when the tenant defaults the landlord can allow the tenant to retain possession of the premises but sue the tenant for unpaid rent. Other options include seeking a temporary restraining order or an injunction against the tenant.

A tenant who has been given an eviction claim may attempt to cure the default and remain in possession by paying costs plus unpaid rent.

If a landlord prevails on an eviction claim and the tenant is still occupying the premises, the landlord should not attempt to remove the tenant. The sheriff is authorized to remove the tenant and the tenant's property, and should be the one to do so. Once the landlord retakes possession of the premises, the landlord does have a duty to mitigate damages.

As mentioned earlier, to collect unpaid rent or damages the landlord will need to bring a collection claim separate from the eviction claim. The landlord should consider the likelihood of success along with the costs and solvency of the tenant before bringing a collection claim. If the amount of damages or unpaid rent is substantial, the claim may be filed in district court. If the amount is minimal (under \$7,500), it should be filed in conciliation court, a.k.a. small claims court. If a landlord is successful with a collection action the court will put a lien on the tenant's non-exempt real estate and levy the tenant's bank account, excluding wages and retirement savings.

Commercial leases often have the tenant's good standing a condition for purchasing or renewing. When a tenant defaults but still desires to renew, the landlord

should take the opportunity to bargain on different lease provisions such as reasonably withholding consent for subleasing or assigning.

Landlords will often want to have a provision in the lease that allows them to cure tenant defaults with or without notice. This provision usually requires the tenant to pay for any expenses the landlord incurs in curing the default including interest. Tenants, on the other hand, will want to be given notice and an opportunity to cure the default whether or not the landlord is able to cure the default.

B. Landlord Default and Tenant Remedies

Although tenant default is the focus of most commercial lease analysis, landlords may also default on a lease by neglecting to follow any of the provisions or covenants just like the tenant. There are many remedies a tenant may seek for a landlord's breach of the lease. These remedies include damages, lost profits, and costs to cure the default.

There are several specific areas where a landlord may breach the lease, and in which a tenant will want to seek remedy. The covenant of quiet enjoyment is one of the most important parts of the lease for the tenant and one that may be broken if the landlord fails to pay real estate taxes or encumbrances. Failure to pay may cause a foreclosure on the premises and therefore a breach of quiet enjoyment. Additionally, landlords have obligations to maintain the facility or building and provide various services. Consistent interruption or failure of these services and maintenance may be cause for remedy. When a landlord causes a default through a maintenance failure, a tenant may be limited in trying to cure that defect, especially tenants occupying a portion of a floor or building.

If a landlord's breach of a provision forces a tenant to terminate the lease, the tenant can recover damages in the form of lost rent and sometimes consequential

damages. The tenant is under a duty to mitigate those damages, and can only recover on those damages that have are supported with specific data. A landlord can limit a tenant's ability to seek remedies by adding a statute of limitations provision in the lease.

A sample default provision:

If: Tenant shall fail to pay any Base Rent, Additional Rent, or other amounts required to be paid by Tenant under this Lease upon the date the same is due, Landlord shall be entitled to immediately and without notice to Tenant terminate Tenant's occupancy and evict Tenant from the Premises.

If: (i) Tenant's interest in the Premises is sold under execution or similar legal process, or (ii) Tenant is adjudicated a bankrupt or insolvent and such adjudication is not vacated within thirty (30) days, or (iii) a receiver or trustee is appointed for Tenant's business or property and such appointment is not vacated within thirty (30) days, or (iv) a reorganization of Tenant or any arrangement with its creditors is approved by a court under the Federal Bankruptcy Act, or (v) Tenant makes an assignment for the benefit of creditors, or (vi) Tenant's interest under this Lease shall pass to another by operation of law, or (vii) Tenant shall admit in writing its inability to make any past or future payment called for under this Lease, then Tenant shall be deemed to have breached a material covenant of this Lease and Landlord may re-enter the Premises and declare this Lease to be terminated.

If: (i) Tenant fails to keep or perform any of the other terms, conditions or covenants of the Lease for more than ten (10) days after notice of such failure shall have been given to Tenant, or (ii) Tenant causes or permits any material damage to or within the Premises and fails to repair such damage within ten (10) days thereafter; then Landlord, besides any other rights or remedies it may have at law or in equity, may either (a) terminate this Lease upon the expiration of ten (10) days after written notice is given to Tenant, in which event the Term shall end on the date set forth in that notice, or (b) re-enter the Premises in accordance with applicable law, dispossess Tenant and/or other occupants of the Premises, remove all property from the Premises and store the same in a public warehouse or elsewhere at Tenant's expense, and hold the Premises without becoming liable for any loss or damage which may occasioned thereby. Tenant agrees that such re-entry by Landlord shall not be construed as an election on Landlord's part to terminate this Lease, that right, however, being continuously reserved by Landlord. Landlord shall not be deemed to

have elected to terminate this Lease unless Landlord provides Tenant with written notice of that election.

If Landlord elects to re-enter the Premises, Landlord may make such alterations and repairs as may be appropriate in order to relet the Premises, and relet all or part of the Premises for such period (which may extend beyond the Term of this Lease), at such rental and upon such other terms and conditions as Landlord in its reasonable discretion believes appropriate. All sums received by Landlord from such reletting shall be applied; first, to the payment of any costs and expenses of such reletting, including brokerage and attorneys' fees and of costs of such alterations, which said alteration costs shall not exceed \$_____ repairs, second, to the payment of any indebtedness other than Base Rent, Additional Rent due from Tenant to Landlord; third, to the payment of Base Rent, Additional Rent and other charges due and unpaid hereunder; and the residue, if any, shall be applied in payment of future payments for which Tenant is responsible as they become due hereunder. If the sums so received during any month are less than the amounts due during that month, Tenant shall pay the deficiency; if such sums are greater, Tenant shall have no right to the excess. The deficiency shall be calculated and paid monthly. Notwithstanding any such re-entry by Landlord, Landlord may at any time hereafter elect to terminate this Lease for such previous breach.

Should Landlord at any time terminate Tenant's right of possession upon a breach without terminating this Lease, Landlord shall also have the right to accelerate the entire indebtedness (including the amount of Base Rent and reasonably estimated Additional Rent reserved in this Lease for the remainder of the Term), reduce the same to present value using a discount rate of ten percent (10%) per annum and recover a judgment from Tenant in that amount. In addition, Tenant shall be responsible, and Landlord may recover a judgment from Tenant, for Landlord's actual costs of constructing any leasehold improvements to the Premises which are not being directly paid for by Tenant together with such brokerage commissions as Landlord may have incurred in connection with this Lease and any other inducements given to Tenant during the Term, including any abated rent (collectively, the "Transaction Costs"). Notwithstanding anything else contained in this Lease to the contrary, upon a default of Tenant, whether or not Landlord shall elect to terminate this Lease, Landlord shall be entitled to recover the unamortized balance of any such Transaction Costs, on an accelerated basis, so as to make the same immediately due and said amount shall be deemed payable as Additional Rent. For purposes of the Lease, the "unamortized balance" shall mean the actual total amount of the

Transaction Costs reduced, however, over the Term, as if said sum were being amortized, at an interest rate of twelve percent (12%) per annum, in equal monthly installments over the number of months Tenant is to pay Base Rent under this Lease. Landlord's right to do so accelerate the unamortized balance of the Transaction Costs shall be an additional remedy of Landlord and shall be exercisable either alone or in combination with Landlord's other remedies set forth in this Lease.

Mention in this Lease of any particular remedy shall not preclude Landlord from any other remedy, in law or in equity.

No waiver by Landlord or Tenant of performance by the other party shall be considered a continuing waiver or shall preclude Landlord or Tenant from exercising its rights in the event of a subsequent default. No acceptance by Landlord of a partial payment tendered by Tenant shall be deemed to be a waiver of the balance of the amount due even if the tender states that acceptance will constitute payment in full.