VI. When the Tenant Says "*The Check Is In The Mail*": Landlord Remedies and Prevention©

DANIEL J. DAVIS
PORTER, ROGERS, DAHLMAN & GORDON. P. C.
800 N. Shoreline, Suite 800, Corpus Christi, TX 78401
361-880-5823 (voice)
361-880-5844 (fax)
ddavis@prdg.com

Firm website: prdg.com

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When the Tenant Says "The Check Is In The Mail": Landlord Remedies and Prevention©

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I. Have They Really Defaulted?

Every lease gives a landlord certain remedies, such as eviction or the collection of damages, that the landlord can use if something the tenant does or fails to do fits the lease's definition of an event of default. But if your lease is like many, it may not clearly define what acts or omissions by the Tenant are "events of default." A tenant may do something – – say, admits to you that it can't pay its debts – – that you think should allow you to use your remedies. But you may, in fact, be powerless to do anything because the lease doesn't define this admission as an "event of default." Just because it seems logical to you that the tenant is in default doesn't mean your lease default provisions agree. To insure that you have remedies against the tenant in situations where you need them, make sure you have a comprehensive definition of an "event of default". Below are 14 items generally considered to be the primary events of default. Some are obvious, others may not be quite so apparent:

A. Nonpayment. They can't make payments required by the lease, including payments to third parties or common area maintenance.

B. All Other Lease Violations. This typically includes violations of covenants which do not involve the payment of money.

C. Chronic Lease Violations. When the tenant commits the same lease violations over and over, your lease needs to have a provision to bring an ultimate stop to that problem. Frequently a lease does this through incurable event of default if the violation occurs more than once within a twelve-month period of time.

D. Falsification Of Reports or Information. This could involve anything from a percentage of rents report to a mis-statement on a tenant estoppel letter.

E. Abandonment of the Lease Space. This can be a significant problem where the tenant's lease space is either high profile, or the absence of the tenant in some other way harms the landlord.

F. Unauthorized Merger, Consolidation or Transfer. Frequently, you may just want to require written consent for such on the landlord's part. Of primary significance is the possibility of using this maneuver to avoid assignment prohibitions.

G. Tenant or Guarantor Dies, Liquidates or Ceases to Exist. If you were counting on a guarantor to secure the payment of the tenant's rent, then you certainly want to keep tabs on the viability of the guarantor as well as the tenant.

H. Tenant Becomes Bankrupt or Insolvent. The need for this provision is obvious, even though under current bankruptcy law it is unenforceable.

I. Sale under Attachment. You should make sure that the default clause includes an assignment or transfer of the tenant's interest in the lease by operation of law, including attachment.

J. Appointment of Receiver or Trustee. This may also be obvious in that it signifies the potential of the tenant to be unable to pay rent or fulfill its lease obligations.

K. Tenant's Inability to Pay Its Debts to Third Parties. This is a particularly good way to catch a tenant that is having financial problems before it files bankruptcy.

L. Change in Either the Net Worth of the Guarantor or the Tenant. This provision is only going to be useful in the event that the lease also requires the tenant and the guarantor to regularly submit financial information.

M. Failure to Reimburse Landlord For Enforcement Costs. This provision is an absolute necessity in order to force a chronically defaulting tenant that cures at the last moment but who is not required to pay your attorney's fees or other enforcement costs. If you include this provision in your lease, then the tenant remains in default until such time as it completely repays the money you've expended to enforce the lease as a result of their default.

N. Catchall Provision. This can include any other Lease violation which is not specifically listed as an event of default. It might also include any type of Nervous Nellie provision which allows the landlord that feels particularly vulnerable to a tenant default which can be shown in some sort of objective and tangible way but which is not specifically described in the lease as an event of default. As you might guess, this is probably the most precarious of the events of default and the one most prone to litigation.

II Landlord Self-help.

A. **Be Careful.** Landlord self-help can be an important remedy, but it must be exercised wisely and in strict conformity with the lease provisions and with the law. The courts do not allow for a breach of the peace by the landlord. If you are in the process of pursuing a self-help remedy and the tenant strongly objects, or you suspect that the tenant will attempt to become physical or that you as the landlord will be required to become physical, then you should cease immediately and withdraw.

B. **Statutory Rights And Prohibitions**. Chapter 93 of the Texas Property Code outlines several self-help remedies such as the landlord's right to re-enter and lock out a tenant. That chapter also specifies what the landlord should not do in re-entering a tenant's Lease space or locking out a tenant. It also specifies that she may not interrupt utilities unless the interruption results from bona fide repairs, construction or an emergency. You may not remove a door, window or attic hatchway unless you are doing so for a bona fide repair or replacement. Even if it is for a legitimate repair, such repair or replacement must be performed promptly. A landlord may not intentionally prevent a tenant from entering the leased premises except by judicial process unless the exclusion results from bona fide repairs, construction or emergency. The landlord may do so to remove the contents of premises abandoned by a tenant. The landlord may also change the door locks of the tenant who is delinquent for at least part of the rent. That chapter also describes how a tenant may re-enter its premises after an unlawful lock out.

III. LANDLORD LIENS.

The scope of this article cannot include a full discussion of both contractual and statutory landlord liens. Contractual landlord liens are certainly the preferred mechanism for enforcing a landlord's security upon the tenant's possessions or other assets. A tenant may contractually agree to a very broad spectrum of rights for the landlord, whereas the statutory landlord lien is somewhat obtuse, limited in its usage and difficult to enforce. See section 54.021 – 025 for the Texas Property Code provisions and requirements relating to commercial building landlord lien. If you're going to enforce a statutory landlord lien, watch your timetables carefully and be diligent in determining abandonment by tenant. The lien for rent is limited to a twelve-month period succeeding the date of the beginning of the rental agreement or the anniversary date. The lien only exists while the tenant occupies the building or until one month after the day that the tenant abandons the building. Additionally, while the landlord may have a priority position at the time of the execution of the lease for the leasehold improvements or assets of the tenant, this position can be lost as a result of new money advanced by another secured party. These requirements are outlined in UCC article 9. A landlord may apply for a distress warrant to the justice of the peace if the tenant owes rent, is about to abandon the leased premises, or is about to remove the tenant's property from the building. While this may sound good, if you have ever attempted to pursue this remedy, you quickly find out that a bond is required and that it is a minefield of problems without the expense of an attorney overseeing the procedure. It is generally not favored by most commercial landlords except in special cases where the landlord is willing to accept the risk because the landlord cannot afford not to pursue the remedy or because of a special benefit which the landlord will receive. In general, the best approach to pursuing enforcement of a landlord lien is a practical one which involves evaluating the potential benefits vs. the cost and risk.

IV. Guaranty Notices and Amendments to the Lease.

Be careful to preserve your lease guaranty, because if your tenant defaults and your other security is inadequate, it may be the only true remedy you have. Hopefully, the guaranty was properly drafted as one of payment rather than collection. Make sure you follow the notice provisions to the guarantor contained in the guaranty agreement. While that may sound simple, improper or no notice required to be given a guarantor could result in the guarantors discharge. Also, prior to agreeing to amendments to your lease with the tenant, make certain that such amendments to not have the effect of releasing the guarantor.

V. Demand Letters.

If you want to provide your tenant with a counterclaim against you, then be careless with your demand letters. Countless landlords whose tenant's have defaulted in the payment of rent or committed some other lease violation have felt particularly abused when they receive a counterclaim or demand letter from the tenant's attorney because of a well-intentioned and

righteous demand letter which was poorly worded. Take the emotion out of your demand letters. Have a set of demand letters which have been reviewed by an attorney who either specializes in lease law or collection law. Make certain that if you are collecting rent that is not your own (as an agent for another party), that you comply with both the Federal and Texas Fair Debt Collection Practices Act. These acts provide penalties for failing to comply with their provisions. If, as a landlord you use a third party to collect your rent or enforce your leases, make sure that they are knowledgeable and have some sort of insurance for when things go wrong. Since they are your agent, their acts will be imputed to you and you will be held responsible for them.

VI. Future Rent.

1. Discounting to Present Value.

Remedies for tenant default specified in leases can sometimes take several forms. Some leases set out rent as a dollar amount for the entire lease term, allowing monthly payment of a set sum. Others merely recite a specific monthly amount of rent due. It has always seemed the better practice to state the entire amount of rent due during the rental term, especially when it comes time to enforce payment of rent against the delinquent tenant. It is much easier for a court to assess future rent when the lease clearly sets out the total amount of rent due for lease term. Most landlords understand that in a court of law their remedy for collecting future rent involves applying a discount for the remainder of the rent due after a tenant has defaulted, assuming the landlord has chosen the proper remedy to enforce. Usually, a landlord will be put to an election of remedies, which may preclude pursuing a different remedy once a landlord has elected to pursue another one. Language in the default and remedy provisions of the lease may avoid some of this; however, once the landlord has chosen to terminate the lease, the landlord may not then go back and terminate only the tenant's right possession. The remedy provisions should be drafted carefully, especially with regard to these two remedies. In electing to terminate the lease, a landlord should be able to pursue collection of future rent discounted to a present value.

2. Traditional Causes of Action.

Texas courts have recognized four causes of action against a tenant for breach of a lease:

a. Landlord can maintain the lease and sue for rent as it becomes due;
b. Landlord can treat the breach as an anticipatory repudiation, and repossess the premises and sue for the present value of the future rentals reduced by the reasonable cash market value of the premises for the remainder of the lease term;
c. Landlord can treat the breach as an anticipatory repudiation and repossess the premises, re-lease the property and sue the tenant for the difference between the contractual rent and the amount received from the new tenant; or
d. The landlord can declare the lease forfeited (if the lease so provides) and relieve the tenant of liability for future rent.

VII Mitigation of Damages.

Mitigation of a landlord's damages is now required by statute and case law. The landlord no longer has the right to sit on his or her hands and do nothing to lessen damages. On July 9, 1997, the Texas Supreme Court
released its unanimous opinion in Austin Hill County Realty, Inc. vs. Palasades Plaza, Inc. 948 S.W.2d 293 (Texas 1997), in which the court set aside 100 years of Texas common law precedent to rule that, with but few exceptions in practice, a landlord has a duty to mitigate damages in the event of a default by the tenant. § 91.006 of the Texas Property Code which was adopted September 1, 1997 states:

> Landlord's Duty to Mitigate Damages
>
> (a) A landlord has a duty to mitigate damages if a tenant abandons the leased premises in violation of the lease.
>
> (b) A provision of a lease that purports to waive a right or to exempt a landlord from a liability or duty under this section is void.

By its terms, the Texas Property Code §91.006 appears to be applicable only to lease disputes where (1) the lease was entered into on or after September 1, 1997 and (2) the tenant abandoned the lease premises in violation of the lease.

The Texas Legislature attempted to codify the result in Austin Hill Country by the adoption of Texas Property Code §91.006. Unfortunately, the legislative enactment was not completely clear and, as a result, the statute does not appear to be applicable to a wide range of cases subject to the Texas Supreme Court opinion in Austin Hill Country. The modern trend among the states has been to recognize that the structures on the land and the use of the structures are more important than the land itself and that leases have taken on more and more of the characteristics of a contract as opposed to a conveyance of land. As the Texas Supreme Court stated in Austin Hill Country "under contract principles, a lease is not a complete conveyance to the tenant for a specified term, such that the landlord's duties are fulfilled upon deliverance of the property to the tenant. Rather a promise to pay in a lease is essentially the same as a promise to pay in any other contract, so the breach of that promise does not necessarily end the landlord's ongoing duties." 948 S.W.2d 298.

In Austin Hill Country, the Supreme Court cited four public policy reasons for adopting a landlord's duty to mitigate damages:

1. Discouraging Economic Waste;

2. Discouraging Vandalism;

3. Requiring mitigation was consistent with the modern trend of disfavor for contract penalties; and

4. The traditional justifications for the common law rule had become unsound in practice. Moreover, the landlord's duty to make reasonable efforts to mitigate does not require that the landlord accept replacement tenants who are financial risks or whose business was precluded by the original lease

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The holding in Austin Hill Country establishes:

A. Duty to Mitigate.

The Supreme Court adopted the rule that a landlord "has a duty to make reasonable efforts to mitigate damages when the tenant breaches the lease and abandons the property, unless the commercial landlord and tenant contract otherwise." The landlord must use "objectively reasonably efforts to fill the premises when the tenant vacates in beach of the lease" 998 S.W.2d at 299.

B. Duty To Mitigate Is Not Absolute.

The landlord is not required to simply fill the premises with any willing tenant.

1. The replacement tenant must be suitable under the circumstances.

2. The landlord's failure to mitigate does not give rise to a cause of action by the tenant. Rather, the failure to mitigate damages bars the landlord's recovery against the tenant only to the extent that damages reasonably could have been avoided.

3. The Supreme Court expressly stated that the landlord and tenant under a commercial lease may waive the landlord's duty to mitigate.

The Texas Supreme Court opinion in Austin Hill Country remains the controlling law.

VIII. Which Remedy is Best for Me.

The determination of which remedy is best for you as a landlord is more than likely going to be determined by the facts of each situation and each lease. Rarely, is a landlord's situation or goal the same with each tenant. A landlord will have to evaluate the strengths and weaknesses of the lease language, the likelihood of collecting from the tenant, the availability of a guarantor, the practicality of the landlord liens and the assets of the tenant and the guarantor. Of course, this is not an exhaustive list of the considerations to determine the best remedy to enforce, but rather a starting point to evaluate a landlord's course of action.