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## Follow Four Strategies to Mitigate Risks of Holdover

*By Alan M. Cohen, Esq.*

Most owner lease forms include onerous holdover provisions that, if unmodified, create significant exposure for commercial tenants. A holdover provision typically penalizes a tenant for its failure to vacate the premises in a timely manner at the expiration of the lease. Penalties for holdover generally include payment of increased rent (often at double or triple the rent due during the last month of the lease), and liability for consequential damages the owner suffers as a result of the tenant's holdover.

It's not unreasonable to penalize a tenant that breaches its contract due to its failure to vacate the premises on time. After all, it's foreseeable that an owner could sustain damages due to a tenant's holdover because as long as the tenant remains in the premises, the owner can't deliver the premises to a new tenant. Nevertheless, many tenants find themselves with no choice other than to hold over following lease expiration pending negotiation of a renewal or a new lease. In fact, under threat of holdover and the penalties associated therewith, tenants often negotiate lease renewals on above-market terms.

Because most holdover provisions include severe penalties for holdover, tenants should pay careful attention to the language used to define "holdover" in their leases. In particular, while most leases define holdover as a tenant's continued occupancy of the premises after lease expiration, depending on the language in the lease, holdover might be triggered simply by a tenant's failure to deliver the premises at expiration *in the condition required under the lease*. So even a tenant that vacates the premises on time could be found guilty of holding over if it doesn't surrender the premises in the condition required under the lease. And such a result wouldn't be totally unreasonable. If a tenant that's obligated to remove significant improvements prior to expiration fails to do so, the owner will be unable to deliver the premises to a new tenant immediately and will incur the same damages it would have incurred had the tenant continued to actually occupy the premises after expiration.

Although it's easy to understand why owners would use such onerous holdover terms, that doesn't mean that you shouldn't protect your own interests.

### How to Level Playing Field

Holdover provisions typically receive less attention during lease negotiations than provisions that will have a more immediate impact on the owner-tenant

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relationship, so owners typically have greater flexibility when it comes to holdover provisions. Tenants should be careful to define holdover narrowly, and to limit the penalties and damages recoverable by owners as a result of holdover. Keep in mind that many commercial owners rely on overly punitive holdover provisions for leverage during renewal negotiations.

The following four strategies, incorporated in our Model Lease Clause: Carefully Draft Holdover Provision, can not only minimize the risk of holdover, but also level the playing field for purposes of renewal:

**Delay assessment of holdover rent following expiration.** Owner lease forms typically require tenants to pay holdover rent at a rate far exceeding market rent. It's common to see an owner lease require holdover rent equal to between 125 percent and 200 percent of the monthly rent due during the last month of the lease term. To minimize the risk of holdover, tenants are advised to delay any rent escalations for as long as possible.

Many owners are willing to delay rent escalation during the first 60 days of holdover. Other owners insist that holdover rent begin accruing on the first day of holdover, but they agree to delay significant increases until the passage of 60 or 90 days. Before agreeing to holdover rent of 200 percent on day one of holdover, try to negotiate a lesser amount, say 125 percent or 150 percent, during the first 60 days of holdover. Most owners are willing to grant a "grace period" before assessing significant rent increases.

**Limit holdover penalties to "base rent."** Most leases define "rent" as the combination of "base rent" and "additional rent." (Additional rent typically includes reimbursement for operating expenses, taxes, and insurance.) Many owners' leases that provide for rent increases during holdover refer only to "rent," without distinguishing between base rent and additional rent. Accordingly, many tenants fall into the trap of agreeing to pay 150 percent or 200 percent of base rent *and* additional rent during holdover.

The most significant components of additional rent are designed to reimburse owners for actual costs incurred. An owner that receives greater than 100 percent of its actual costs arguably receives a windfall. Therefore, try to limit any increases during holdover to "base rent."

**Include a waiver of consequential damages.** Holdover rent is designed to compensate owners for damages they could sustain as a result of holdover. Accordingly, holdover rent is a form of "liquidated damages." A tenant that agrees to holdover rent in excess of the rent it normally would pay should include a statement that holdover rent represents all the tenant will be obligated to pay in the event of holdover. Language should be included in the holdover provision indicating that holdover rent constitutes liquidated damages, which shall be the owner's exclusive remedy in the event the tenant fails to vacate the premises in a timely manner following the expiration of the lease.

The holdover provision also should include a waiver by the owner of any damages resulting from holdover. While no tenant wants to pay holdover rent, holdover rent can be a benefit to a tenant if it limits its exposure for damages the owner might sustain as a result of the tenant's failure to vacate

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the premises on time, such as damages resulting from the owner's inability to enter into a lease with a new tenant.

Sophisticated owners might be hesitant to waive their rights to recover consequential damages. While many owners are reluctant to agree to an absolute waiver of consequential damages, some owners are willing to waive consequential damages resulting from holdover during the first 60 or 90 days after the lease expires.

### **Delete language tying holdover to tenant's obligation to make repairs.**

Many leases define holdover as a tenant's failure to deliver the premises following expiration of the lease *in the condition required under the lease*. Courts have found that a tenant's failure to remove improvements and restore the premises can subject a tenant to the consequences of holdover. In 2009, a Texas appeals court decided that because tenants failed to remove their improvements and restore the premises, they were subject to the holdover provision under their lease [Cammack the Cook, LLC v. Eastburn, Sept. 2009].

Recently, the U.S. District Court for the District of Kansas interpreted the "Surrender of Premises and Holding Over" provision in a commercial lease, and ruled in favor of the tenant, despite the tenant holding over its space. There, the tenant vacated the premises on time, but after vacating spent approximately \$40,000 over a period of four months making repairs to the premises.

The owner sought rent at the holdover rate of 150 percent for the period of time between the date the tenant vacated the premises and the date the tenant's repairs were completed. The owner argued that the language in its Surrender of Premises and Holding Over provision creates a holdover where property is not surrendered in proper condition and repair—that is, that the surrender conditions and holdover provision are conjunctive. One paragraph of the lease provided: "Upon the expiration of this lease ... Tenant shall immediately surrender the Premises to Owner ... in broom-clean condition and in good order, condition and repair, except for ordinary wear and tear..." A second paragraph provided: "If Tenant holds over after the expiration of the ... [Term] ... Tenant shall become a tenant on a month-to-month tenancy at monthly rent equal to 150% of the Rent in effect during the last full month of the preceding term."

The court disagreed with the owner, concluding that "although the surrender conditions and holdover provisions appear in the same section of the lease agreement, they are in two distinct paragraphs." According to the court, "the plain and ordinary meaning of the term 'holding over' in this section of the lease agreement refers to the failure to surrender property, not the failure to make required repairs or failure to surrender in a particular condition" [Fairfax Portfolio, LLC v. Owens Corning Insulating Systems, LLC, Feb. 2013].

It is the requirement that the premises be delivered in the condition specified in the lease that could subject a tenant to holdover penalties even after it vacates the premises. Following lease expiration and the return of the prem-

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ises, owners and tenants frequently fight over the condition of the property and the tenant's repair obligations. A tenant that vacates the premises on time, but fails to complete all repairs required of it under the lease, could be liable for holdover penalties until it completes the repairs required under the lease. Disputes over repair obligations following expiration can take months if not years to resolve, depending on the size and condition of the premises.

Therefore, because a tenant found liable for the cost of repairs also could be found liable for holdover rent, and damages resulting from holdover, if the tenant's failure to deliver the premises in the condition required under the lease triggers the holdover provision of the lease, tenants would be wise to avoid any language that defines holdover as the tenant's failure to deliver the premises *in the condition required under the lease*. ♦

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### MODEL LEASE CLAUSE

#### Carefully Draft Holdover Provision

Here's a holdover provision, provided by Texas attorney Alan M. Cohen, which incorporates four strategies to help a tenant mitigate its holdover risks. Ask your attorney about using it in your leases.

#### HOLDING OVER

If Tenant, or any party claiming by, through, or under Tenant, fails to surrender the Premises at the expiration or earlier termination of this Lease without a written agreement of Landlord which supersedes this Section, the continued occupancy of the Premises shall be that of a tenancy from month to month; and (a) with respect to the first month of such holdover period, Tenant shall pay as liquidated damages an amount equal to the total stated Base Rent for the last full one-month period immediately preceding the holdover, (b) with respect to the second and third month of such holdover period, for each month of holdover Tenant shall pay as liquidated damages an amount equal to 125% of the total stated Base Rent for the last full one-month period immediately preceding the holdover, and (c) with respect to the fourth month of such holdover period, and for each month thereafter until Tenant vacates the Premises, Tenant shall pay as liquidated damages an amount equal to 150% of the total stated Base Rent for the last full one-month period immediately preceding the holdover. Additional Rent shall be paid by Tenant during any period of holdover on the same terms and conditions in effect during the last full one-month period immediately preceding the holdover. No holdover by Tenant or payment by Tenant after the expiration or early termination of this Lease shall be construed to extend the Term or prevent Landlord from immediate recovery of possession of the Premises by summary proceedings or otherwise. It is expressly agreed that the liquidated damages specified under this paragraph represent the Parties' best reasonable estimate and approximation of the damages likely to flow from Tenant's failure to timely vacate the Premises. The Parties have negotiated these liquidated damages in good faith, and the Parties acknowledge and agree that such liquidated damages do not constitute a penalty. Recovery by Landlord of the amounts set forth in this Section shall be Landlord's exclusive remedy in the event of holdover by Tenant. Tenant shall not be liable for consequential or other damages resulting from holdover.