Tschetter Sulzer
ATTORNEYS & COUNSELORS AT LAW

Mark N. Tschetter
Victor L. Sulzer
Peter E. Muccio
Lindsay E. Jasper
Karen A. Harvey
Rachel L. Griffin
Kory J. Cook
Christopher R. Cunningham
Jonathon G. Carlson

Denver
Tel 303.699.3484
Fax 720.449.0160

Colorado Springs
Tel 719.550.8004
Fax 719.227.1181

Grand Junction
Tel 970.822.7020

Evictions
Tel 303.766.8004
Fax 303.766.1181

3600 S. Yosemite St.
Suite 828
Denver, CO 80237

www.thslawfirm.com

THIS DOCUMENT CONTAINS CONFIDENTIAL INFORMATION THAT IS INTENDED ONLY FOR TSCHETTER SULZER CLIENTS. DO NOT DISTRIBUTE THIS ADVISEMENT.

2021 LAWS LEASE ADVISEMENT

Date: August 2021

To: Tschetter Sulzer Clients

From: Tschetter Sulzer

Re: Lease Related Advisements Based on 2021 Laws

INTRODUCTION

Anyone retaining Tschetter Sulzer (TS) to review their lease or anyone purchasing a lease from TS should read this document. In addition to the standard and ongoing opinions TS offers, this document breaks down and analyzes the significant legislation enacted during the 2021 Colorado General Assembly Session.

Required lease changes resulting from the new laws involve immediate critical operational decisions. Accordingly, decision makers need to be integrally involved in lease review and decision process. Because of the complexity of the various issues, decision makers will need to spend the necessary time to meaningfully participate in the lease revision process and the process of dealing with existing leases.

Lease advice or any lease sold by TS complies with current federal and state laws in our opinion. However, any lease and or lease language can be challenged, regardless of the amount of time and expertise spent on creating it. Additionally, judges, as individuals, are not always predictable and may sometimes make rulings that contradict the lease and/or contract law. Accordingly, TS

© 2021 Tschetter Sulzer. All Rights Reserved

cannot guarantee any lease clause will always be enforced or never challenged, but our overall goal, to the greatest extent possible, is to provide lease language and advice that can be successfully defended in court if challenged.

Given the length of this document and the number of issues involved, every effort has been made to assist you in navigating both the document and issues starting with a table of contents. Further, the document also contains links that allow the reader to jump to related material and also back to the table of contents.

TABLE OF CONTENTS

© 2021 Tschetter Sulzer. All Rights Reserved

OVERVIEW

In 2021, the Colorado General Assembly enacted two separate laws. Both House Bill HB21-1121 (HB1121) and Senate Bill SB21-173 (SB173) significantly affect leases. SB173 goes as far as to "prohibit" certain lease clauses. Because the impact of these two laws are wide ranging and significant, all landlords should take the time to familiarize themselves with the many intricacies and nuances of how these laws impact lease agreements. This is not an especially glamorous or desirable task. To the contrary, given the number of issues and minutia involved, this is an arduous task. However, it is a necessary task because you can't make sound business decisions regarding your lease and operations without a full understanding of the issues and corresponding risks.

In making operational and policy decisions, all landlords should be aware and accept that a significant amount of legal uncertainty has been created by HB1121 and SB173 (collectively the "new laws"). The uncertainty is primarily driven by how the General Assembly drafted the legislation, when it became effective, and what was not included in the legislation. For example, HB1121 became effective immediately when the Governor signed it on June 25, 2021. Because of the almost immediate effective date, landlords were given zero time to prepare for legal changes that significantly impact both leases and operations. The chaos likely to unfold because of HB1121 could have easily been avoided if the General Assembly would have given landlords time to prepare by adding language that HB1121 applies to leases signed on or after September 1, 2021. However, they did not and as a result HB1121 immediately impacted existing leases creating what we call "Cutover Issues". Similarly, SB173 also resulted in significant cutover issues. All landlords should familiarize themselves with cutover issues and the potential for them to impact both leases and operations.

© 2021 Tschetter Sulzer. All Rights Reserved

With uncertainty comes risk. Only each individual landlord can decide how much risk they are willing to accept. A major purpose of the TS 2021 Lease Advisement is to help landlords make risk related decisions by providing a full discussion and analysis of the issues and provide a range of options with corresponding risk levels. However, even the most thorough analysis cannot prognosticate with guaranteed certainty how the courts will address many issues. We are literally sailing into uncharted waters. Further, we most likely won't be able to chart a clear course for some time. Until we start receiving court rulings, how the various county courts will rule on many of these issues is unclear. Further complicating the landscape is the potential for the various county courts to interpret the new laws differently. Unfortunately, this was one of the most disturbing lessons from the pandemic (different counties ruling differently). For example, Denver and Weld County to this day remain outliers by still erroneously requiring Covered Properties to serve 30-Day Rent Demands.

Hopefully, after reading this document, you understand the issues sufficiently to make necessary decisions. If we are working with you on a lease, we will discuss these issues with you further and answer any questions.

EFFECTIVE DATES

Return to Table of Contents

HB1121 Effective Date

HB1121 became effective immediately upon the Governor's signature on Jun 25, 2021.

SB173 Effective Date

SB173 becomes effective on October 1, 2021.

HB1121 ISSUES

Return to Table of Contents

HB1121 Forced the Definition of Rent to Change

Prior to HB1121, the concept of rent was simple. A good lease made all amounts due and payable under the lease "rent". An example of such a provision is:

> Regardless of whether specifically stated in any applicable provision of this Lease Contract or any addenda, any and all rent, amounts, charges, sums, damages, or money

© 2021 Tschetter Sulzer. All Rights Reserved

owed by you under this Lease Contract or any addenda shall be considered rent, and we shall have all remedies for non-payment of any amount including eviction.

However, when HB1121 became effective, landlords were prohibited from increasing "rent more than one time in any twelve-month period of consecutive occupancy by the tenant". If your lease contains this or similar language, all amounts are considered rent. Since all amounts are "rent", any increase in these amounts will be considered a rent increase under HB1121. Accordingly, your lease should be written so that any amount the tenant has to pay beyond the base monthly rent is not rent so that increases in these amounts are not considered an automatic "rent increase" and thus your once a year allowable rent increase under HB1121.

Why the Definition of Rent Matters

Because there are numerous amounts, fees, and charges due under a lease, classifying some as "rent" and others as "not rent" becomes problematic. Accordingly, TS lease drafting philosophy is to classify the monthly rent as rent and all other amounts as not rent. Because other amounts are not rent under this drafting model, landlords should be aware that they cannot evict tenants for not paying other amounts alone by posting them with a rent demand. Rather, a landlord's remedy is to serve the tenant with a demand for compliance or possession. For example, if the tenant had several unpaid month to month fees on the ledger, the remedy would be to serve a 10-Day demand for compliance or possession and not a rent demand. Since both a rent demand and a demand for compliance or possession are 10-Day demands, there is little practical difference. If a tenant hasn't paid the base monthly rent, TS still recommends serving a rent demand and adding the "other amounts" to the rent demand.

With respect to all of the amounts, sums, fees, and charges due under your lease, if you want to break from the TS lease drafting philosophy and classify some items as "rent", you will need to let us know. But again, keep in mind that any amount "classified" as "rent" would be considered a rent raise under HB1121 if it increases even if the increase is not planned or is inadvertent.

HB1121 Cutover Issues - Inadvertent Rent Raises

Cutover issues are lease issues that need to be addressed because they were impacted by the adoption of the new laws, but the changes can't be made permanently until the tenant signs a new lease that has the permanent lease changes in them. In other words, cutover issues apply to existing leases and these issues can't be fixed until the tenant signs a new lease.

As discussed above, many (most) leases make all amounts owed rent (all amounts, charges, sums, damages, or money owed under this Lease Contract shall be considered rent). If your lease contains this or similar language, all amounts are considered rent. THIS MEANS ANY INCREASE IN THESE AMOUNTS MAY BE CONSIDERED A RENT INCREASE under

© 2021 Tschetter Sulzer. All Rights Reserved

HB1121. Accordingly, we highly recommend that you review your lease for potential inadvertent rent raises.

One of the biggest potential inadvertent and automatic rent raises is caused by Month to Month (MTM) fees. For example, a lease might have an automatic month to month fee which is considered "additional rent". If your lease classifies all amounts as rent and has an automatic MTM fee that kicks in if the tenant holds over with permission, this would be a rent raise.

HB1121 cutover issues along with all other cutover issues are discussed below under the heading CUTOVER ISSUES Section.

SB173 ISSUES

Return to Table of Contents

Late Fee Limitations

SB173 imposes the following limitations on late fee:

> (1) a landlord shall not take any of the following actions or direct any agent to take any of the following actions on the landlord's behalf: (a) charge a tenant or homeowner a late fee unless a rent payment is late by at least seven calendar days; (b) charge a tenant or homeowner a late fee in an amount that exceeds the greater of: (i) fifty dollars; or (ii) five percent of the amount of the past due rent payment. C.R.S. 38-12-105(1)(a)&b(i)(ii)

Leases Should Define When Rent is Late

Most leases do not clearly define or specifically state when rent is "late". Rather, the date rent is "late" is implied or derived from the language. For example, the NAA Lease provides as follows.

> If you don't pay all rent on or before the [BLANK] day of the month, you'll pay a late charge.

Assuming the 3rd is inserted into the BLANK, the logical interpretation is that rent would be late if not paid by the 3rd or would be late on the 4th. Remember, under SB173 a late fee cannot be imposed "unless a rent payment is late by at least seven calendar days". This then raises the issue (because the date the rent is "late" is not specifically defined) as to whether the late fee can be imposed on the 11th or the 12th. Some might argue the rent is late on the 4th so the 4th should count (4, 5, 6, 7, 8, 9, 10) and thus the late fee could be imposed on the 11th. However, the more conservative position is to assume the 4th does not count but rather is the trigger to start

© 2021 Tschetter Sulzer. All Rights Reserved

the seven (7) day count on the 5th. Under this interpretation, the late fee would be imposed on the 12th (5, 6, 7, 8, 9, 10, 11 = the seven days).

This illustration is one of many that demonstrates the "uncertainty" created by the new laws as discussed in the Overview Section. This illustration and the corresponding discussion is also important because it is a key cutover issue. You have leases for existing tenants. These leases do not specify when the rent is "late". You are going to have to decide whether and when you will impose a late fee for these leases, and if so, the amount of that late fee. Tenants may challenge your decisions. These are not risk free decisions because SB173 imposes liability on landlords for violating its late fee limitations.

To eliminate these issues and based on the language of SB173, we are recommending that all leases define when rent is late because again SB173 prohibits the imposition of a late fee "unless a rent payment is late by at least seven calendar days". Accordingly, stating when the rent is "late" is critical to start the seven calendar day count imposed by SB173. For example, if rent is due on the first, then you will want your lease to state that "rent is due on the 1st and late if not paid on or before the 1st." Note, if rent is due on the first and considered late if not paid on the first, then based on SB173 you couldn't charge a late fee until the 9th (2, 3, 4, 5, 6, 7, 8 = seven calendar days after the rent was late).

Imposing Late Fees More in Line with the Status Quo

With rent traditionally being due on the first, many clients have expressed concern about late fees not being imposed until the 9th of the month. The legitimate concern is that most tenants won't pay until the 7th or 8th, if late fees don't kick in until the 9th. Is there a way to impose late fees more in line with the current status quo meaning late fees can be imposed on the 4th or the 6th?

The answer is Yes. Your lease can be written in a way that late fees could be imposed on the 4th or the 6th as they currently are now. SB173 only limits a) the amount of late fees; and b) mandates that late fees can't be charged before the rent is "late" for at least seven calendar days. SB173 does not dictate when landlords can say the rent is "due" or "considered late".

Accordingly, if you want to levy the late fee on the 4th of the month if rent is not paid by the 3rd, appropriate lease language can be drafted. For example:

> Rent is due and payable in advance of the month for which it is owed. Specifically, rent is due on or before the 24th day of the month prior to the month for which rent is owed. Rent not paid on or before this day is late. If tenant fails to pay the rent within seven

© 2021 Tschetter Sulzer. All Rights Reserved

calendar days of the rent being late, tenant agrees to pay a late fee of either $50 or 5% of the late rent payment whichever is greater. Landlord agrees not to charge tenant such late fee before the 4th of the month for which such rent is owed.

Why the 24th? Because if landlord wants to consistently charge the late fee on the 4th without issues or incident, you need to factor that February usually only has 28 days so to get the seven days to comply with SB173 it has to be due on the 24th (25, 26, 27, 28, 1, 2, 3). Obviously, this means in typical months, the tenant is getting more than 7 days before the late fee kicks in. Specifically, the late fee isn't being imposed for 10 days for 31 day months (25, 26, 27, 28, 29, 30, 31, 1, 2, 3) and 9 days for 30 day months.

Based on the language of SB173, there is nothing that would prevent a landlord from moving up the rent due date in order to impose late fees more in line with today's status quo. However, as stated many times, until this language is challenged and sustained in court it is not without risk. Potentially, a court could hold that this language is prohibited by the "intent" of SB173 even though this intent is not expressed in the statute. While we deem this a remote possibility based on the law and the language of SB173, only individual landlords can determine whether it is a risk they are willing to accept, especially in light of the potential significant liability for violating SB173's late fee provisions.

The 5% Issue - Five Percent of What?

Under SB173, late fees are limited to the greater of $50 or five percent (5%) of "of the amount of the past due rent payment". This creates yet another SB173 potential uncertainty. A hypothetical discussion will quickly illustrate this issue.

- Tenant's rent is $1700 per month
- Prior to October rent becoming due, Tenant pays $1,000
- The remaining balance owed for October is $700
- Tenant does not pay the remaining $700 for October on time and has a balance owed for the October rent of $700
- The lease provides that if rent is not paid timely, the tenant owes a late fee of $50 or five percent of the unpaid rent payment whichever is greater.

Assuming the late fee is now owed, what is the amount of the late fee?

1. $85 or 5% of $1700?
2. $35 or 5% of $700?
3. $50 because the late fee owed is 5% of $700 which is $35, but $50 is greater than $35?

© 2021 Tschetter Sulzer. All Rights Reserved

The answer all turns on what does "the amount of the past due rent payment" mean? Two distinct interpretations seem logical.

The 5% of the Ledger Balance Camp

This camp would argue that the late fee should be $50. "[T]he amount of the past due rent payment" is $700 because the tenant already paid $1000 toward the $1700 monthly rent. This is confirmed by the fact that when the tenant didn't pay the remaining rent, the landlord posted the tenant for $700. Since 5% of $700 is $35, the late fee is $50 because $50 is greater than $35. This camp would further argue that in today's climate many judges will find for the tenant or will hold the amount is whatever lowers the amount of the late fee.

The 5% of the Monthly Rent Camp

This camp would argue that the tenant owes an $85 late fee. The monthly rent is $1,700. The tenant's $1000 prepayment is irrelevant. The $1,700 was not paid on time and is past due. Thus, "the past due rent payment" is $1,700 and 5% of $1,700 is $85. The five percent of the monthly rent camp argues that the amount the landlord posted the tenant for is irrelevant. The full $1700 has not been paid and therefore is past due so the late fee is $85. Tenants cannot lower their late fee by making a partial payment or because they have a credit. Late fees on almost any contract are all or nothing and not a percentage of the balance. You either paid what you promised to on time or you did not.

Landlords will Need to Make the 5% Decision

TS's position is that the expression "of the amount of the past due rent payment" means five percent of the monthly rent which is past due because it has not been paid in full. However, like many other issues associated with the new laws, this issue remains uncertain until we receive court rulings. Because of the potential liability for violating SB173's limitations on late fees, landlords need to decide whether they want to take the more conservative position and charge 5% of any balance owed if the balance is less than the full monthly rent.

Landlords should also note that this issue can almost entirely be avoided by not taking partial payments. If you don't take partial payments, then this issue would only arise if somehow the tenant had a credit on the ledger lowering the base monthly rent. Further, even if a tenant had a balance, small balances might be offset by other charges on the ledger such as a garage or pet fee. Finally, if a landlord does decide to take the more conservative approach (the 5% of the outstanding balance position), then the property management software needs to be programmed to this effect and to override the percentage calculation if the $50 was greater as in our example.

Liability for Violating SB173's Late Fee Limitations

Return to Table of Contents

© 2021 Tschetter Sulzer. All Rights Reserved

Landlords face significant potential liability for violating SB173's limitations on late fees. The statute specifically provides that:

- Any non-complying late fee provision is "void and unenforceable"
- Landlords who violate shall pay tenants a penalty in the amount of fifty dollars for each violation
- In addition to the $50 penalty, landlords who receive written notice of a violation must cure said violation within seven days
- Landlords who fail to cure violations within seven days may be found liable in a civil action for:
    - compensatory damages for injury or loss suffered
    - a penalty of at least one hundred fifty dollars but not more than one thousand dollars for each violation payable to the tenant
    - costs including reasonable attorney fees
    - any other equitable relief the court finds appropriate

Once a lease has a complying late fee provision, landlords liability for SB173 violations are greatly reduced if not entirely eliminated. With a facially complying late fee provision, the only potential liability arguably would be for imposing the 5% late fee on the full amount of the monthly rent when the tenant either made a partial payment or had a credit balance. As just discussed, this scenario won't occur frequently and can almost entirely be eliminated by not allowing partial payments of base monthly rent. Further, a landlord charging 5% of the monthly rent rather than 5% of any balance could avoid significant liability by paying the $50 penalty, refunding any difference (curing) which would also be a small amount, and then charging the 5% in the future based on the amount owed on the ledger. However, managers of substantial portfolios could potentially receive $50 demands for a substantial number of units over a number of years for instances where they imposed a 5% charge on the total monthly base rent rather than a 5% of the ledger balance owed at the time.

As discussed below, landlords face the greatest SB173 liability for Cutover Issues. Fortunately, once you have a complying lease and all your units have turned and are now on the complying lease, all potential liability based on cutover issues goes away.

Prohibition of Specific Lease Clauses

Return to Table of Contents

SB173 prohibits two specific types of lease clauses. Any lease in Colorado must not include:

© 2021 Tschetter Sulzer. All Rights Reserved

(a) an unreasonable liquidated damages clause that assigns a cost to a party stemming from an eviction notice or an eviction action from a violation of the rental agreement; or

(b) a one-way, fee-shifting clause that awards attorney fees and court costs only to one party. Any fee-shifting clause contained in a rental agreement must award attorney fees to the prevailing party in a court dispute concerning the rental agreement, residential premises, or dwelling unit.

While this section of the statute does not contain penalties and damages similar as to those for violating SB173's late fee provisions, any lease clause that violates this portion of SB173 is "null and void and unenforceable".

Liquidated Damages

Lease Break Fees - Liquidated Damages - Legal Refresher

Anyone who has worked in the rental industry knows that liquidated damages or lease break fees provisions are commonly used in Colorado residential leases. As we have been telling clients for years, despite their wide use, no Colorado legal authority supports the enforceability of a liquidated damages clause in a residential lease. Specifically, no Colorado Appellate Court (Colorado Court of Appeals or the Colorado Supreme Court) has ever issued a ruling that liquidated damages are a proper measure of damages in a residential lease. The only court to address the issue struck down a liquidated damages provision because the landlord could not meet one of the required elements ("landlords cannot demonstrate why any damages resulting from tenant's breach are "difficult to prove"). Kirkland v. Allen, 678 P.2d 568, 571 (Colo. App. 1984). Based on the language from the case, arguably the Kirkland Court overlooked the requirement that the difficulty in determining damages is determined as of the time the contract is made.

Overall, legal arguments can be made for and against the enforceability of liquidated damages in residential leases. Tenants attacking a liquidated damages clause would argue that Colorado landlord/tenant legal precedent law on damages supports the conclusion that liquidated damages are not enforceable. Other states that have addressed this issue have ruled both ways, with some states enforcing, and other states not enforcing.

Until a Colorado Appellate Court issues a specific ruling on the issue, the ultimate legal enforceability of liquidated damages in a residential lease remains uncertain, and thus use of a liquidated damage clause in a residential lease is at the party's risk. Given the lack of clear Colorado case law on the subject, county courts (the court where liquidated damage clauses are litigated) regularly issue various and inconsistent rulings in cases involving liquidated damages in residential leases. Some courts enforce. Other courts do not enforce. Still other courts issue

© 2021 Tschetter Sulzer. All Rights Reserved

equitable rulings regardless of lease language, i.e. the court ignores the liquidated damage clause and determines damages based on when the tenant vacated and when the unit was re-rented.

Despite the uncertainty of liquidated damage clauses being legally enforceable, many Colorado landlords suffer from the false impression that liquidated damages provisions are always enforceable. The legality of or legal enforceability of lease break fees comes up nearly a 100% of the time in county court collection proceedings or when a collection agency is attempting to collect a balance. While landlords win some of these collection battles over lease break fees both in and out of court, the clear trend is moving against landlords especially where the liquidated damage provisions are unreasonable. Thus, the more liquidated damages are challenged, the more landlords are either losing, settling, or withdrawing the claims for such damages. Accordingly, the false impression that liquidated damages are always enforceable was almost entirely created by a lack of resistance on the part of tenants.

Lack of Notice Fees

First and foremost, a lack of notice fee is simply another form of liquidated damages. Many landlords don't realize this or don't consider this fact when setting and charging lack of notice fees. Accordingly, when setting the amount and determining when to charge it, landlords need to realize the fee is a form of liquidated damages that is added to any other liquidated damages being charged in order to determine if the total amount of damages being imposed is "reasonable".

The lack of notice fee is in most leases in addition to lease break fees. A lack of notice fee is charged whenever a tenant moves out without giving proper notice as required by the lease. The rationale is that the landlord is damaged or put at a disadvantage in their efforts to re-rent the unit. Specifically, many landlords would argue "but for" your lack of notice I would have had somebody lined up to move in immediately or shortly after you moved out. Because you didn't give me notice, I didn't have somebody lined up and now I'm losing rental days that I wouldn't have otherwise lost. Overall, the rationale and arguments for lack of notice fees make more sense for small landlords with a unit or a couple of units because the turn, make ready, and reletting process is more of an event. As opposed to multifamily communities which turn, and lease on a constant basis.

Frequently, if not universally, the two items (lease break fees and lack of notice fees) are charged together. When a tenant breaks his lease and doesn't provide notice, the landlord charges both a lease break fee and a lack of notice fee. As discussed below, we did not recommend this before SB173 and advise against it now. Regardless of what is called or the rationale for it, again like a lease break fee the lack of notice fee is liquidated damages. If you are charging both a lack of notice fee and a lease break fee the likelihood of the total added together being an "unreasonable estimate of presumed damages" is substantial to the point of almost being certain. Further,

© 2021 Tschetter Sulzer. All Rights Reserved

charging both is also vulnerable to the double dipping argument because both the lack of notice fee and the lease break fee are designed to compensate the landlord for lost rental days. TS's advice regarding the charging of notice fees and lease break fees is significantly based on these realities.

Reletting and Buyout Fees

No discussion of liquidated damages would be complete without touching upon reletting fees and buyout fees because they often get intertwined with lease break issues. Further, many landlords don't understand their purpose and proper use. Thus, they are often incorrectly used and charged.

The NAA Click and Lease accurately describes the purpose of reletting fee:

> The reletting charge is not a lease cancellation fee or buyout fee. It is an agreed-to liquidated amount covering only part of our damages, that is, our time, effort, and expense in finding and processing a replacement resident. These damages are uncertain and difficult to ascertain—particularly those relating to inconvenience, paperwork, advertising, showing apartments, utilities for showing, checking prospects, office overhead, marketing costs, and locator-service fees. You agree that the reletting charge is a reasonable estimate of such damages and that the charge is due whether or not our reletting attempts succeed.

Accordingly, reletting fees are not lease break fees but damages specifically linked to the reletting process. Thus, a reletting lease clause should not ever be used as a substitute for a well drafted lease break fee clause.

Similar to lack of notice fees, the rationale and the argument for reletting fees is much stronger for small landlords because a lease break and the unexpected need to re-rent the unit is much more of a task and an event for them. As opposed to multifamily communities which are turning and leasing all the time. Small landlords are much more likely to incur additional and specific reletting costs and expenses when a tenant breaks. For example, if Larry Landlord has three units managed by Marvelous Management, Larry may have agreed to pay Marvelous a full month's rent to sign a new tenant. Reletting fees originated in commercial leasing and the recovery of leasing commissions was a primary driver. In a multifamily environment, the community is almost certainly paying continuously for advertising and marketing regardless of whether a tenant breaks their lease.

TS recommends that multifamily communities do not impose reletting fees. If the community does charge a reletting fee, the fee most likely should be low and tied to specific reletting related cost that would not have been incurred but for the tenant breaking their lease. If the community

© 2021 Tschetter Sulzer. All Rights Reserved

can clearly demonstrate higher out of pocket costs tied specifically to the defaulting tenant, the community would be justified in charging a higher reletting fee as long as the fee isn't duplicative of other damages being levied per the lease. If a multifamily community does impose reletting fees, especially significant ones, the community should be prepared to have them challenged. As noted, many tenant attorneys will argue that the community is incurring reletting related costs regardless of the tenant's breach.

While buyout fees are frequently mistaken for "lease break fees", buyout fees are different from both reletting fees and lease break fees. The major difference is that buyout fees can be negotiated (not always) and are voluntarily exercised at the option of the tenant. If the tenant has executed a buyout agreement, typically the tenant has the option to get out of the lease by paying the agreed upon buyout fee. Accordingly, buyout fees should never be unilaterally imposed as a "lease break fee". If the tenant signed a buyout agreement and breaks the lease and doesn't pay the buyout fee, then the landlord would exercise its remedies under the lease including imposing a lease break fee if there was one.

Lease Break & Lack of Notice Fees - Liquidated Damages After SB173

SB173 did not change the law of liquidated damages but rather reinforced it. Specifically, SB173 prohibits " an *unreasonable* liquidated damages clause that assigns a cost to a party stemming from an eviction notice or an eviction action from a violation of the rental agreement". (Emphasis added). The key word being "unreasonable". Although SB173 didn't change the law of liquidated damages, it did squarely put a flood light on the reasonable element of liquidated damages.

For liquidated damages provision to be enforceable it must meet a three part legal test. The legal test is:

> (1) "the parties intended to liquidate damages"; (2) "the amount of liquidated damages, when viewed as of the time the contract was made, was a reasonable estimate of the presumed actual damages that the breach would cause"; and (3) "when viewed again as of the date of the contract, it was difficult to ascertain the amount of actual damages that would result from a breach." Ravenstar, LLC v. One Ski Hill Place, LLC, 401 P.3d 552, 555 (2017)

With SB173 clearly placing the spotlight on the "*reasonable estimate of presumed damages",* TS anticipates that the clear trend of courts striking down "unreasonable" liquidated damages provisions to only accelerate. The acceleration of this trend will also be greatly fueled by the fact that liquidated damages provisions will be challenged much more often because tenants are much more likely to be represented by attorneys very much aware of this issue. A measure to

© 2021 Tschetter Sulzer. All Rights Reserved

provide attorneys to tenants in every eviction case is very likely to be on the Denver County Ballot in November.

What Are Reasonable Liquidated Damages In Light of SB173?

With the focus now squarely on the reasonableness of liquidated damages, what are reasonable liquidated damages? The best answer to this question starts by defining what are not reasonable liquidated damages.

Some leases levy a sixty-day notice (two months) for lack of notice and a two month lease break fee. Accordingly, a tenant who breaks a six month lease after five months and fails to give notice is being charged four months of rent. If the rent is $1700 per month, this would be a charge of $6800 for breaking a six month lease. This generally wasn't flying before when challenged and certainly will never fly now after SB173. On the reasonableness issue, tenant attorneys will likely focus on how long it took you to re-rent. If you are re-renting in an average of 15 days, the Court is not going to find that 4 months of rent is a "reasonable amount".

Regardless of amounts, many leases impose liquidated damages for both failing to give notice and a lease break fee. As we have advised clients for years, landlords should not be charging both a lack of notice fee and a lease break fee. If a tenant breaks their lease, charge the lease break fee. If a tenant doesn't break their lease but fails to give notice, charge the notice fee. Again, this practice was not successful in court for the most part when challenged and certainly will not be upheld now after the passage of SB173. Accordingly, TS strongly reinforces its long time recommendation for landlords not to charge both notice fees and lease break fees.

As far as amounts go, without specific documentation, the enforceability in court of anything more than one month's rent will be up in the air and subject to interpretations of various county court judges. This would be both for a lack of notice fee and a lease break fee. Our opinion is based on current trends, the current rental market, the passage of SB173, and the fact that liquidated damage amounts will be challenged much more often. Based on this, we strongly recommend for clients to move away from the "sixty-day" notice requirement.

While one month's rent is the maximum amount we see being consistently enforced for both notice fee and lease break fees, it is not the best measure for either a lease break fee or a notice fee. The best measure would be based on how long it takes you to re-rent. For example, if last quarter, it took you an average of 20 days to re-rent, then your notice and lease break fee should be set at 20 days. Obviously, market conditions change so this amount should be adjusted quarterly or semi-annually. If challenged in court, you have a strong argument that the amount is a "reasonable estimate" of your actual damages.

© 2021 Tschetter Sulzer. All Rights Reserved

The change in the legal landscape from SB173 putting a spotlight on liquidated damage provisions in residential leases will be dramatic. Accordingly, we recommend having detailed conversations with asset managers and owners that push back to changes in operations based on changes necessary to minimize risks that have increased because of SB173.

Future Rent As the Tried and True Alternative

We are confident that some landlords disagree with our opinions on liquidated damages. Specifically, they contend that higher amounts are necessary to compensate for actual lost rental days when a tenant breaks a lease. Because they are concerned about not being compensated for these lost rental days, these landlords view reducing liquidated damages as problematic. For those landlords who hold these views, there is a simple bullet proof solution. Eliminate the lease break fees and lack of notice fees from your lease and insert a future rent clause. When future rent is the remedy, landlords are awarded damages for each and every lost rental day only subject to the landlord's duty to mitigate such damages by making efforts to re-rent the unit. If a tenant breaks a one year lease after eight months and the landlord can't re-rent for 5 months. The tenant is liable for four months of rent. In short, with a future rent clause the tenant is liable for each and every day of rent that they agreed to pay during the term unless somebody else paid it. The future rent remedy also has the major advantage of being legally unassailable. Colorado Appellate courts have ruled time and time again that future rent is a legally endorsed method of determining damages when residential tenants break their lease. Finally, future rent clients have also informed us of another major advantage. When tenants know that they are on the hook for the entire term if they walk out, fewer tenants break their leases. If landlords want to give tenant's the flexibility to break for legitimate reasons (buying a house, job transfer, etc.), landlords can combine a buyout option with a future rent remedy.

Recovering Attorneys' Fees For Filing Eviction Cases

Return to Table of Contents

Prohibition on One Way Attorney Fee Shifting Provisions

SB173 also prohibits

> a one-way, fee-shifting clause that awards attorney fees and court costs only to one party. Any fee-shifting clause contained in a rental agreement must award attorney fees to the prevailing party in a court dispute concerning the rental agreement, residential premises, or dwelling unit.

With respect to attorneys' fees, the American Rule is that neither party gets fees absent a statute or a contractual provision. A contractual provision that "shifts" the responsibility to pay attorneys' fees onto the losing party is called a "fee-shifting provision". Prior to the enactment of SB173, one-way fee shifting attorney provisions were legal in leases. A one-way attorney fee

© 2021 Tschetter Sulzer. All Rights Reserved

provision meant that the landlord would get attorneys' fees if the landlord won but the tenant would not if the tenant won. Now all attorney fee shifting clauses in leases must award fees to the prevailing party.

Even if your lease already contains a "prevailing party" provision, this is an important issue because it along with the statutory cure rights created by SB173 significantly complicates the ability of landlords to recover their attorneys' fees and cost for having to file an eviction when a tenant doesn't pay the rent. To make the issue clear, we will first need to understand the new right to cure.

Statutory Right to Cure

SB173 requires landlords to:

> accept payment of the tenant's full payment of all amounts due according to the notice, as well as any rent that remains due under the rental agreement, at any time until a judge issues a judgment for possession.

The tenant's right to cure cannot be waived in a lease agreement. The tenant's right to cure before entry of a possession judgment has significant operational ramifications. Per the statute, the tenant only has to pay amounts set forth in the notice as well as any rent that remains due under the lease. This is a big departure from the status quo.

Under the old system or current status quo, once a rent demand expired, the landlord was under no obligation to accept the tenant's payment or proposed cure. Using this leverage, if a tenant offered to pay after the 25th of the month now, almost all landlords would insist that as a condition of accepting the payment, the tenant would also have to pay next month's rent. The logic is simple. The landlord doesn't want to be right back in court in a couple of weeks. Under the old system you could compel this payment, because you were under no legal obligation to accept the payment. Post SB173, if a tenant offers to pay near the end of the month, landlords can't insist that the tenant also pay next month's rent. Under the new system even if the tenant paid on the 30th or the 31st, you would have to accept the payment without next month's rent.

Similarly, the right to refuse payment after a rent demand expired made collection of attorneys' fees and costs straightforward regardless of the attorneys' fee lease provision. The landlord would not accept payment unless the tenant also paid the attorneys' fees and costs. Because the landlord had no obligation to accept the tenant's payment after expiration of the notice, the landlord could even condition acceptance of the tenant's payment upon receipt of the attorneys' fees even when there was no lease provision regarding attorneys' fees.

© 2021 Tschetter Sulzer. All Rights Reserved

Collecting Attorneys' Fees When a Tenant Statutorily Cures

Given SB173's prohibition against one-way fee shifting provisions and the right to cure, landlords must carefully plan and execute that plan to collect their eviction attorneys' fees and costs incurred because of the tenant's default in paying the rent. Specifically, landlords must meet two conditions to collect attorneys' fees for having to file a nonpayment eviction when the tenant statutorily cures.

1. The lease must contain specific lease language making the tenant responsible for the payment of landlord's attorneys' fees and costs if the tenant statutorily cures.

2. The amount of the landlord's attorneys' fees must be contained in the Rent Demand because the tenant is only obligated to pay the total amount in the Rent Demand.

Based on the statutory language, unless the lease contains a specific agreement to pay landlord's attorneys' fees and those fees are contained in the notice, landlords cannot insist on the tenant paying eviction related attorneys' fees when statutorily curing. In our opinion, this specific lease clause needs to be separate and different from a simple prevailing party provision. A typical prevailing party attorney fee looks like this.

> The court shall award the prevailing party from the non-prevailing party attorney's fees and all other litigation costs.

The tenant's agreement to pay landlord's attorneys' fees and costs when statutorily curing looks like this.

> If you exercise your statutory right to pay in response to an eviction notice after the notice has expired and after our attorney has filed an eviction case with a court to enforce our legal rights but before the court has entered a judgment for possession, you agree to pay us our current attorney's fees and court costs as set forth in the eviction notice in addition to any other amounts due pursuant to the lease and all other amounts set forth in the notice. If we file an eviction case and the court determines the possession issue, attorneys' fees and costs will be awarded to the prevailing party as determined by the court consistent with the parties' intent to have attorneys' fees and court costs awarded to the prevailing party in disputed court actions as set forth in paragraph X of this Agreement.

Again, this is a major change to the current status quo and confusing for a lot of landlords. Unfortunately, the confusion on this issue will likely cause disputes and problems in the short run. Specifically, even though the statutory language and the tenant's obligation to pay being limited to amounts in the notice plus rent that has become due, many landlords are likely to

© 2021 Tschetter Sulzer. All Rights Reserved

continue to insist on payment of eviction attorneys' fees as a condition to accepting a tenant's statutory cure payment.

Statutory Right to Cure - Additional Necessary Lease Language

While we are talking about the statutory right to cure, we need to make another important point. The statutory right to cure also dictates that leases contain additional language in addition to the specific attorney fee language. Specifically, to avoid disputes, your lease should specify the process and procedures to be followed if a tenant exercises their right to statutorily cure amounts owed.

Per SB173, the tenant can pay you or the court. You can't control whether the tenant pays the court. However, if the tenant pays you, the process should be clearly spelled out to prevent tenants from falsely alleging that they tried to cure (pay) when they did not. SB173 forces you to accept payment but it does not prohibit you from dictating the payment process in your lease. For example, "if the tenant exercises their right to statutorily cure, the tenant will make all such payments in certified funds in person in the onsite leasing office. Landlord agrees to provide a receipt for all such payments". Obviously this language won't work for every landlord and clauses will have to be specifically tailored to specific operations.

However, landlords may not have lease language or procedures that would make it difficult to pay or otherwise create barriers for the tenant to pay (exercise their right to statutorily cure). Further, the process specified in your lease can't change what is due or the amount the tenant needs to pay to cure. Remember, per SB173, you have to accept "full payment of all amounts due according to the notice, as well as any rent that remains due under the rental agreement". Thus, you can require the tenant to pay in certified funds and in person at the leasing office. But you can't try to force payment of additional items that aren't in the notice. As we have discussed consistently in our Webinars, this puts a premium on generating accurate notices that include everything that is owed under your lease including attorneys' fees and costs for having to file the eviction.

Additional Attorneys' Fees Considerations for Leases

Attorneys' fees frequently comprise the largest portion of money spent and awarded in landlord tenant court cases. For example, in a typical security deposit court case, even if the deposit is reasonable and the damages are tripled, the damage award may be $3,000 (a $1,000 security deposit x 3). However, if successful, the tenant's attorney might ask for $7,500 in attorneys fees and you may have incurred $1000s of dollars in your own attorneys' fees for having to defend the case. Further, when landlords win in court and are awarded attorneys' fees, frequently the tenant can't pay them so that the award is nothing more than a piece of paper. On the other hand, because landlords are able to pay attorneys' fee awards, this creates an incentive for attorneys to take tenant cases. Taking these facts into consideration, landlords should evaluate whether they

© 2021 Tschetter Sulzer. All Rights Reserved

want to limit their potential liability exposure for tenant attorneys' fees and costs. Appropriate lease language can limit both the amount of attorneys' fees awarded and the types of cases for which they are awarded. For example, if the court case is about a breach of the lease (breach of contract), the lease may provide that the prevailing party gets their attorneys' fees. However, the parties (the landlord and the tenant) are also free to limit the amount of fees. For example:

> The court shall award the prevailing party from the non-prevailing party attorney's fees and all other litigation costs not to exceed $2500. The parties agree that the non-prevailing party in any court case shall not be liable to or responsible for paying the prevailing party for more than the $2500 agreed to amount for attorneys fees, court costs, or other litigation related costs.

The goal of placing limits on attorneys' fees is two fold. One, for the landlord to recover the landlord's anticipated reasonable fees for routine eviction and collection cases if successful in court. Because it is not an exact science, limiting fees may result in the landlord not recovering their actual fees. Two, to disincentivize tenant attorneys' from taking cases against them by limiting their ability to recover attorneys' fees from the landlord. In short, is limiting the landlord's potential to recover fees worth significantly decreasing the amount of fees the landlord would have to pay in a losing court case and potentially decreasing the possibility of that case even being brought because there is no incentive for an attorney to take it?

Similar to monetary limits, landlords can also attempt to limit the recovery of attorneys' fees in types of cases or based on types of claims. For example, attorney fee language can specify that the parties agree that "neither party shall be awarded attorneys' fees and costs if "a party is seeking exemplary, punitive, sentimental or personal-injury damages".

Overall, given the uncertainty of future litigation and rulings on SB173 combined with the anticipated flood of warranty of habitability claims, we recommend for landlords to limit their monetary exposure to attorneys' fees and costs by placing a limit on both the landlord and the tenant to recover attorneys' fees and costs. Individual landlords will have to determine what limits they deem appropriate and that they can accept.

CUTOVER ISSUES FOR EXISTING LEASES

Return to Table of Contents

Cutover Issues Created By New Laws Are Problematic

Cutover issues created by the new laws are potentially extremely problematic and you should be prepared to deal with them. What is a cutover lease issue? Both HB1221 and SB173 have effective dates (June 25 and October 1). Prior to these dates, you signed leases with tenants and

© 2021 Tschetter Sulzer. All Rights Reserved

these leases extend beyond those dates. Your existing leases worked and did not have illegal or unenforceable provisions. After these dates, your existing tenant leases may contain provisions that either have become problematic or illegal because of the new laws.

A late fee lease provision illustrates the nature of cutover issues and the options for dealing with them.

- Tenant's lease signed prior to October 1, 2021 states:
    - Monthly Rent is $1,500
    - Tenant's Late Fee is $100

- $100 is both greater than:
- $50 and $75 (5% of $1500 is $75)

Accordingly, this late fee provision was legal but now is illegal after October 1, 2021. First and foremost, you need to recognize this fact. Second, after identifying cutover issues, landlords need to determine how they are going to deal with them.

Let's turn back to our example to guide us through the discussion. There are only two possible interpretations of the late fee after SB173's effective date of October 1, 2021. One, the $100 late fee is reduced to $75 (5% of $1500) to make it complying with SB173. Two, the $100 late fee is completely void and the landlord cannot charge any late fees. The logical interpretation would be for a court to reduce the late fee to the complying maximum. However, tenant attorneys will argue that the provision is "completely void now" because of the statutory language.

Unfortunately, the specific language of SB173 gives them an argument, creates an incentive for them to make the argument, and creates risks for landlords who lower non-complying late fees to the new legal maximum under SB173.

SB173 specifically provides the following on late fees:

- Any non-complying provision is "void and unenforceable"
- Landlords are liable for $50 for each violation
- Landlords that fail to cure within 7 days are liable for damages and penalty of at least $150 not to exceed $1,000
- Plus attorneys' fees and costs

While the SB173 language on prohibited clauses doesn't have the penalties and damages for liquidated damage clauses or fee shifting provisions, it does similarly state that these violating clauses are "void and unenforceable". Because of the statutory language, tenants and tenant

© 2021 Tschetter Sulzer. All Rights Reserved

advocate attorneys are likely to argue that any "late fee provision" or any "lease break fee" provision in an existing lease, is "null and void" as of October 1, 2021.

Legal authority supports the conclusion that a contractual provision that was legal when made should not be totally stricken, but rather reduced or modified in accordance with the change of the law. Based on this, courts should reduce late fee amounts and not strike them entirely. With respect to lease break fees and notice fees (remember notice fees are a form of liquidated damages), the courts will be more likely to strike them in their entirety if they are found to be "unreasonable". As discussed in the liquidated damages section, the law already requires liquidated damages to be reasonable. Further, the clear remedy for unreasonable liquidated damages is to strike an unreasonable liquidated damages clause in its entirety and not reduce it to an unreasonable amount. Accordingly, every landlord should evaluate their potential liability and risk if a liquidated damages clause is stricken.

When evaluating the late fee cutover issue, landlords should consider other factors as well. One factor is it worth fighting over? Even if you win, it might be a pyrrhic victory. For example, your late fee is over the line so you unilaterally reduce it to 5% of the rent. Tenant challenges and loses. You win but now you have spent a lot of time and money fighting over $25 (from our example). Another is whether it is worth the risk or potential liability. Again, your late fee is over the line. You decide to reduce it. You get challenged and lose. The attorneys who challenged it discovers that you manage 2000 units, they now file a class action lawsuit challenging the fee on all of your leases.

Another factor is that violation of SB173 is an affirmative defense to an eviction for non-payment of rent. Tenant does pay the rent. You file an eviction. Part of the demand contains the $75 late fee which was reduced by $25 from the now illegal amount of $100. The Court determines that the late fee is "void". You lose the eviction case.

Overall, courts should reduce excessive late fees and not strike them but we simply won't know until courts start issuing rulings on this issue. Landlords that are risk averse should take the most cautious approach on cutover issues. Because during the pandemic, courts certainly issued rulings that were not supported by the law in our opinion especially in Denver County. For example, Denver County continues to insist that Covered Properties serve 30-Day rent demands.

The bottom line on all of this is we think that the amounts of excessive late fees will be reduced and not struck, but we don't know until we see how it plays out in Court.

Evaluating Cutover Issues

In dealing with cutover issues, landlords should:

© 2021 Tschetter Sulzer. All Rights Reserved

- Review their lease
- Determine if issue is a problem
- Decide what to do

For example, look at your lease and determine whether your late fee is > than $50 or 5% of the monthly rent.

- If it is not, than there is no issue
- If it is, you need to decide how you will handle the issue

Options for Handling Cutover Issues

Landlords with cutover issues need to decide what option to use to address. None of the potential options is a perfect solution. However, some options come with substantially less risk. We will once again turn back to our late fee example to discuss potential options. Remember, in our example, the rent was $1500 and the late fee was $100 so it exceeds the new SB173 maximums ($100 is greater than both $50 or 5% of $1500).

Elect Not to Enforce

By far the option with the least amount of risk. Until the landlord can get the tenants on a new lease, the landlord does not enforce late fees in any existing leases. Potentially problematic from an operational perspective because the software has to be programmed to charge some tenants late fees and not others. The downside is lost revenue and tenants may be disincentivized to pay on time because there is no consequence. Remember, late fees are just one potential cutover issue. Lease break fees (liquidated damages) are another. Not enforcing lease break provisions would likely lead to an even bigger revenue loss.

Amend the Lease

Another option would be to amend the lease. Specifically, an agreement that the $100 late fee is now lowered to $75. However, this cannot be done unilaterally. You need the tenant's cooperation. Some tenants won't cooperate. If the tenant doesn't cooperate and sign a Lease Amendment, the landlord will need to make further decisions. Will you unilaterally lower the late fee for those tenants who won't sign? Will you send these nonsigning tenants notice that the late fee has been lowered? Are you going to not enforce? What will your response be for those tenants who refused to both sign the Amendment and pay the late fee? Attempting to amend the lease makes sense for landlords with a few units. For landlords with significant units, the strategy may not make as much sense because the process could be difficult to manage.

Cutover issues involve critical operational decisions, and thus decision makers need to be integrally involved in the process. Decision makers can't meaningfully participate in the lease revision process and the process of dealing with existing leases without understanding the issues. Decision makers are going to have to put in the time to understand the issues. Decision makers can't fly by at 50,000

© 2021 Tschetter Sulzer. All Rights Reserved

feet and make good decisions. To Minimize Cutover issues, lease revisions should be done as soon as possible. Cutover issues go away once you have a complying lease and turn all units. **Finally, all renewals should be full renewals with complete paperwork and not just one page extensions.**

Key Cutover Issues

The Key Cutover Issues Are:

- Month to Month Fees (Because under HB1121 almost certainly a rent raise)
- Late Fees
- Liquidated Damage / Lease Break Fees
- Attorneys' Fees

Bolstering Security Deposit Language

TS recommends for all landlords to evaluate current security deposit lease language and make changes if needed to have more flexibility in dealing with numerous issues caused by or that may result from SB173 and HB1121. One significant issue is potentially small unpaid amounts on a tenant's ledger. As discussed above, HB1121 necessitated for many amounts previously classified as rent to be converted to fees to avoid inadvertent rent raises. Even though these items are not "rent", landlords can still evict for nonpayment by serving a demand for compliance or possession as opposed to a rent demand.

However, if landlords have appropriate security deposit lease language, landlords would have the ability and flexibility to resolve these small ledger balances without having to initiate eviction proceedings (at least initially). Similarly to HB1121, SB173 may result in small unpaid ledger balances because of late fee limitations. Specifically, SB173 prohibits landlords from evicting tenants for unpaid late fees only. To be able to resolve small ledger balances that may result because of these new laws, we recommend strengthening security deposit language to allow landlords to use security deposits to clear these balances and then require the tenant to replenish the tenant to replenish the security deposit to its original amount. Example language:

> Landlord may use a portion or all of tenant's security deposit at any time to pay any amounts owed by Tenant. If Landlord applies any portion of the security deposit for any purpose while tenant is in possession of the Premises, Tenant upon demand from Landlord shall pay the amount necessary to restore the security deposit to the original amount.

While there is no guarantee that the tenant will pay the amount to replenish the security deposit, landlord would have the right to evict for non-compliance of this covenant after serving a 10-Day demand for compliance or possession. In addition to bolstering the security deposit

© 2021 Tschetter Sulzer. All Rights Reserved

language, landlords may want to consider increasing security deposits to cover anticipated small unpaid ledger amounts. For example, if the average tenant pays late twice over a twelve month lease and the late fee is $75, the landlord could increase the security deposit by $150 and apply the money.

© 2021 Tschetter Sulzer. All Rights Reserved