

PROPERTY LEASING



Stephen Posen
416.369.4103
sposen@mindengross.com



Stephen J. Messinger
416.369.4147
smessinger@mindengross.com

ASK THE EXPERTS

Tenant's Rights

While commercial leases will vary from agreement to agreement, all leases will contain provisions that aim to protect the rights of the landlord and the tenant. The level of protection provided to each party depends on what is specifically negotiated for in the lease, in addition to the rights that are available at law. With respect to the rights of a tenant that can be found in a commercial lease, there are a number of ways in which they can be described and categorized. Naturally, there are the tenant's common law rights, which are those that have arisen as a result of judicial precedent. There are fundamental rights, which come from the common law and are categorized as rights that are fundamental in order for a tenant to achieve the entire benefit of the contract. Finally, there are special rights, which are specifically negotiated for in order to provide the tenant with a benefit it would otherwise not be entitled to. The following group of cases address how these rights are interpreted, protected, and adjudicated in the current landscape of commercial leasing.

Quiet Enjoyment

A landlord's covenant of quiet enjoyment is one of the cornerstones of a commercial lease. A tenant's right to peaceably possess, use, and enjoy its premises without interference, interruption, or disturbance from other parties is the ultimate marker of a tenant's leasehold interest. The case of *Kjargaard Heating & Cooling Ltd. v. Chakraborty* illustrates how a tenant has a claim for breach of quiet enjoyment if the actions of a landlord or its agent substantially interfere with the tenant's possession.

In this case, the Lease was for an unspecified term and provided for 90 days notice of termination if the Landlord wanted to redevelop the building. The Lease also provided the Landlord with the right to post "for rent" or "for sale" signs during the last 90 days of the term. One month after the Tenant opened for business, the Landlord advised that it wished to sell the building and its agent posted "for sale" and "business relocating" signs near the Premises. Through conversations with the Landlord's broker, the Tenant understood

that she was being evicted and proceeded to move out. The Landlord sued for rent for the balance of the term after the Tenant vacated. The Tenant counterclaimed for damages for breach of the implied covenant of quiet enjoyment and constructive eviction.

The Court found that the placing of the “for sale” and “business relocating” signs indicating that the defendant was relocating, as well as the disruptive showing of the Premises during business hours, interfered with the Tenant’s enjoyment of her business for the usual purposes. The Court reminded us of the principle stated in the Ontario decision in *Arangio v. Patterson*: “Where the breach is intentional or the probable consequence of intentional conduct, the consequences are foreseeable, the interference has the character of permanence and wrongfulness, and the degree of interference is so substantial or intolerable as to make it reasonable for the Tenant to vacate, then the breach will be found to constitute a constructive eviction.”

Transfers: The Consent Requirement

The following cases illustrate some of the issues that continue to arise between landlords and tenants in the context of transferring leases. Leases increasingly include detailed provisions to address these issues, such as prescribing a formal process to request consent or carefully defining permitted transferees. However, every year there are situations before the court to determine application and interpretation that leave commercial leasing lawyers scratching their heads at the court’s decisions.

In *Smith v. 2249778 Ontario Inc.*, the Tenant entered into an Agreement to sell its business and requested the Landlord’s consent to the assignment of the Lease, which could not be unreasonably withheld. The Lease provided the Landlord with the right to terminate the Lease instead of granting its consent, after which the Tenant had the option to withdraw its request and reinstate the Lease. Here, the Landlord elected to terminate and the Tenant exercised its right to reinstate the Lease. Notably, the market value of the Leased Premises had increased since the Landlord and Tenant had originally entered into the Lease. The Tenant brought an application for a declaration requiring the Landlord to permit the assignment, arguing that the Landlord’s right to terminate was only available if there was a reasonable basis to withhold consent. The Court found that the reasonableness requirement in withholding consent applied only to granting or refusing consent, and not in the case of the Landlord’s termination right. Rather, the Landlord’s termination right was clever bargaining – if market rent was less than the Lease rates at the time of the request, the Landlord could consent. However, if market rent increased, as it did in this situation, the Landlord had the opportunity to terminate the Lease and get the benefit of the current higher market rate from a new Tenant.

The decision in *Hudson’s Bay Co. v. OMERS Realty Corp.* is one that will undoubtedly influence how big-time landlords draft the transfer provisions in their standard forms of lease, possibly making a tenant’s right to transfer without the landlord’s consent gradually scarce. From a litigation perspective, Hudson’s Bay also provides insight into how provisions concerning permitted transferees and changes in control may be interpreted in light of the practical commercial context. This case shows that courts may not be willing to assess the real interests in the property and operations of a business beyond the strict terms of an assignment of lease.

In *Hudson’s Bay*, the Tenant entered into a joint venture with a third party and sought to transfer three existing Leases to a limited partnership, whereby the third party would have a beneficial ownership interest in the Leases. The Landlord, who was in direct competition with the third party, refused to consent even after the joint venture was restructured to limit the third party’s degree of control over the Leases. The Tenant argued that the assignment was covered by the exception for affiliates under the Lease, which meant the

Landlord's consent was not required. The trial court found in favor of the Tenant and the Landlord appealed on the grounds that the court overlooked the commercial reality of the transaction. The Landlord argued that changing the beneficial ownership of the entity holding the Leases would result in a change of control in the Tenant. The Court of Appeal found that the Landlord's characterization of the effect of the assignments went beyond the scope of the Lease terms and affirmed the trial court's decision that the Landlord's consent was not required.

Renewal Rights

The following cases exemplify the complexities of drafting and exercising options to renew in the commercial leasing context. Renewal rights are some of the most important special rights that a tenant can negotiate into its lease and some of the easiest rights to inadvertently lose if the preconditions to exercise are not strictly followed. Tenants are advised to eliminate or limit preconditions to exercise or, if a landlord insists, should try to tighten up any conditions and be as clear as possible. In addition, tenants should begin negotiating a renewal well in advance of the deadline.

Mapleview-Veterans Drive Investments Inc. v. Papa Kerollus VI Inc. considers whether the respondent Tenant was entitled to exercise a right of renewal. The Tenant purported to exercise the option to renew within the exercise period, but the appellant Landlord rejected the notice on account of noncompliance with the preconditions to exercise because there were additional rent arrears.

The Landlord applied to the Court for a declaration that the option itself was void for uncertainty because there were no guidelines for calculating rent or, in the alternative, that the Tenant was in breach of the preconditions such that the Tenant's exercise of the option was void.

The Tenant argued that the rental arrears were on account of the Landlord improperly accounting for additional rent and unfairly demanding higher payments in an attempt to squeeze the Tenant out. The application judge was sympathetic and found that there was a live issue regarding the amount of outstanding rent. A trial was ordered to determine the arrears, following which the Tenant would pay the amount owing and the renewal rent would be determined.

The Landlord appealed and the Court of Appeal agreed that the clause was not void for uncertainty because the formula for establishing the renewal rental rate was described as "*the then current rate*," which was the functional equivalent of saying the "then market value" or the "then prevailing market rate". The Court allowed the appeal on the basis that the Tenant could show that it satisfied the preconditions to exercise, which included complying with its rent obligations. Notwithstanding that the Tenant disputed the amount owing, as long as the Landlord had made a demand for the funds pursuant to the terms of the Lease, the Tenant was required to pay in order to avoid default and loss of its renewal right. Furthermore, the time for exercising had now expired and the Tenant was given 30 days to vacate the Premises.

Understandably, non-default under the Lease is a very common precondition to exercise a renewal right. Landlords are not often keen to extend a tenancy with a defaulting party. Tenants should try to limit such preconditions to defaults in existence at the time of exercise so that past defaults don't result in losing the right. In addition, tenants should try to add notice and cure periods to preconditions, such that a tenant would only lose its option if it was then in default and it failed to cure the default after receiving notice from the landlord. Though a landlord may not agree to such language, the Tenant may have retained its right if the Lease provided that any *bona fide* dispute that the parties were working to resolve would not constitute a default under the Lease.

In *Osteria Da Luca Inc. v. 1850546 Ontario Inc.*, a supposed miscommunication regarding a renewal term resulted in the Tenant losing its space altogether. In this case, the parties verbally discussed the Tenant's wish to extend the term and to expand its Premises in the months before the term expired. The Tenant did not have an option to renew or extend and therefore its right was dependent upon the Landlord's agreement. When the Landlord determined that it was unable to expand the Tenant's Premises, it rented the Premises to another party and terminated the Lease. The Landlord later took the position that it understood the Tenant's desire to extend the term was conditional upon leasing more space.

The Tenant initially brought an application for a declaration that the Lease be renewed for a further five-year term, which the Tenant then amended to seek an interim injunction permitting it to remain in possession for a six-month period in order to relocate and wind up its current business in the Premises.

The Court held that the Landlord was aware that the Tenant was acting in accordance with a verbal agreement to renew for five more years and granted a three-month injunction in the Tenant's favor.

In considering whether an interlocutory injunction was an appropriate remedy, the Court found that there was a serious issue as to the misrepresentation by silence in allowing the Tenant to remain in the Premises without knowing that the Landlord would not enter into a new Lease with it. In addressing this issue, the Court cited the landmark decision in *Bhasin v. Hrynew* noting that there is now a duty of honesty in contractual performance.

Risk

Increasingly in contracts and particularly in commercial leases, parties have begun to heavily negotiate specific provisions into a lease agreement in order to effectively allocate risk. While these provisions aim to provide protection to either the landlord or tenant in difficult situations, the unpredictability and uniqueness of issues that arise during the term of a lease create unforeseeable circumstances that often require judicial intervention. These cases illustrate how courts currently address the issues of damage, destruction, and indemnification.

Damage & Destruction – Does a Tenant's Negligence make it Responsible for Damages?

The damage and destruction provisions in a commercial lease fall into the category of those "just in case" provisions that both parties hope to avoid during the lease term.

In *Poole Properties Ltd. v. Stevens*, an unknown person started a fire behind a building using mattresses and a box spring that had been left there by the Tenant. The fire caused damage to the exterior of the building and the Landlord claimed damages from the Tenant for his alleged negligence. The Tenant counterclaimed against the Landlord in the amount of his damage deposit, which he alleges was wrongfully retained.

The Court considered three issues:

1. Did the risk of loss by fire pass to the Landlord under the Lease?
2. If the risk of loss by fire did not pass, is the Tenant liable for damages?
3. Was the Landlord entitled to retain the Tenant's damage deposit pursuant to the Lease?

The Court found that the Lease placed the risk of loss by fire on the Landlord, as it had expressly covenanted to fully insure the Building. The Tenant contributed to the cost of the Landlord's insurance covering all risks to

the Building and should not be deprived of that benefit unless the Lease expressly said so. While the Lease required the Tenant to repair any damage caused by his negligence, carelessness, or misuse, the repair clause did not provide that it took priority and applied notwithstanding the other terms and covenants in the Lease.

Even if the Lease did not place the risk of loss by fire on the Landlord, the Court did not find that the Tenant breached the terms of the Lease or caused damage to the building through negligence, carelessness, or misuse. The Landlord was aware that the Tenant left mattresses behind the Building and never objected. Finally, the Court found that the Landlord's deduction from the damage deposit was excessive and granted the Tenant's counterclaim.

Indemnification – Whose Risk is it Anyway?

In *Midland Plaza Inc. v. Midland Medical Services Inc.*, the Landlord and the Tenant entered into a Lease in a retail plaza for a 10-year term starting on December 1, 2009. Under an indemnity agreement, the Tenant's Indemnifiers would be automatically released if the Tenant did not default three times in the first three years (defined as a "habitual default").

The Landlord claimed the Tenant defaulted in the payment of rent at least nine times in 2011. When the Lease was assigned to a new Tenant in 2012, each of the defaults had been cured and the Indemnifiers confirmed their continuing liability under their indemnity despite the assignment. In April 2013, the Lease was re-assigned to the original Tenant, who subsequently failed to pay rent for January and February 2014. The Landlord terminated the Lease on February 4, 2014, and brought a motion against the Indemnifiers for damages arising from the termination of the Lease for the balance of the term.

The Indemnifiers argued based on the principle of *contra proferentum*, commonly known as "interpretation against the draftsman" that absent a definition of "default" in the Lease, the Lease should be resolved in the Tenant's favor. Since the Landlord did not terminate for late payment when the default was cured within the month, "default" should mean late payment of rent going longer than one month. Alternatively, the Indemnifiers argued that the previous assignment effectively operated as a waiver or estoppel by convention, which would stop the Landlord from relying on prior defaults.

The Court held that the application of *contra proferentum* would defeat the commercial purpose of the indemnities in the first place. The release of the indemnities was conditional on lack of "habitual default" which, by definition, referred to defaults that have not resulted in a termination of the Lease. The Court relied on the ordinary meaning of the word "default" and found that a failure to pay rent at the time prescribed was a default and that the failure to pay rent on time on nine separate occasions constituted a habitual default.

In addition, the Court found that the Indemnifiers failed to establish any waiver of prior defaults or estoppel by convention as there was no evidence of a common assumption between the Landlord and the Indemnifiers that the 2011 defaults would not be relied upon.

The case of *Deslaurier Custom Cabinets Inc. v. 1728106 Ontario Inc.* is an update from the Superior Court decision we included in last year's article. As a reminder, the Superior Court found that the Landlord was liable for the Tenant's uninsured losses after the Building was destroyed by a fire caused by the Landlord's contractor while performing the Landlord's work on the structural components of the Premises.

The Court considered the relationship between the Tenant's obligation to obtain insurance coverage and the Landlord's covenant to indemnify the Tenant for any "damage to the Premises" as a result of "the act, default,

or negligence of the Landlord or its contractors, invitees, or licensees.” The Court held that, if the meaning of “Premises” signified nothing more than the rentable area (as the Landlord suggested), then the Landlord would have provided a meaningless indemnity for something for which the Tenant had no interest. Thus, “Premises” included the Tenant’s property and the Landlord was liable for the Tenant’s uninsured losses. The Tenant’s contractual obligation to obtain insurance coverage was limited by the Landlord’s express covenant to indemnify the Tenant.

Good news for Landlords: the Court of Appeal found that the Superior Court did not properly apply the principles of contract interpretation and relevant case law, and erred in finding that the Landlord’s indemnity took priority over the Tenant’s obligation to insure. The Tenant’s obligation to insure against all risk of loss or damage to its own property caused by fire relieved the Landlord from liability. In addition, had the Tenant complied with its obligation to add the Landlord as an “additional insured”, the Tenant would not have been able to bring a subrogated claim against the Landlord. As such, the Tenant should not be able to benefit from its breach and bring a subrogated claim against the Landlord.

Default & Remedies

Within all commercial leases there are obligations for both the landlord and tenant and consequences for not fulfilling these obligations. When a party fails to fulfill their obligation, or is in “default”, the common law or specific lease provisions allow an innocent party to enforce their rights and seek specific remedies. The specific nature of the default will generally indicate which remedy will be available to the innocent party. The following cases look at how some of these defaults are characterized and the availability of certain remedies to both tenants and landlords. Specifically, we will look at how courts have recently handled situations when a tenant has breached its repair obligations; the remedies of relief from forfeiture, waiver, and injunctions; and the significance of the limitation period when seeking remedies.

Breach of Repair Obligations

Lundy’s Regency Arms Corp. v. Niagara Hospitality Hotels Inc. is a lesson for tenants to carefully consider the full scope of their obligations under the maintenance and repair provisions in a lease. In light of the other “big ticket” lease provisions, maintenance and repair provisions often seem less important to a tenant during lease negotiations. In this case, it was clear that the parties spent time allocating the responsibility for maintenance and repair work and the Court was unwilling to overlook the Tenant’s breach.

This action arose out of the sale and leaseback of commercial property, under which the Tenant agreed to maintain and keep the Premises in such condition as a careful owner would. The Landlord terminated the Lease and brought an action for damages. The Court awarded the Landlord \$1.7 million in damages for breach of the repair obligations. The Court held that the repair provisions in the Lease were consistent with an enhanced standard that goes beyond what would otherwise be required of a Tenant in the absence of such language. The Court also relied on the representations and warranties of the Tenant, as the Vendor, under the Purchase Agreement, which stated that it was not aware of any material defects or deficiencies in the structure or systems. The Tenant was unable to satisfy the burden of showing that such deterioration fell within the scope of the reasonable wear and tear exception in the Lease and thus had to pay damages.

Relief from Forfeiture

The remedy of “relief from forfeiture” is the ultimate form of judicial forgiveness in the commercial leasing world. With its roots in the *Commercial Tenancies Act* and the *Courts of Justice Act*, the courts are empowered

to use their discretion and give a tenant a second chance by setting aside a landlord's termination if, in the circumstances, it is just and reasonable to do so.

In *Strata Plan VIS2030 v. Ocean Park Towers Ltd.*, the Tenant was entitled to relief from forfeiture despite the court acknowledging that the Landlord had validly terminated a 99-year Lease on account of the improper use of certain parking stalls. The trial court found that, while the breach was serious and had persisted for some time, there had not been a significant interference with the owner's use of the building, nor any prejudice to its interests. On the other hand, there would be a disproportionate consequence to the Tenant to deprive it of its long-term asset. The Tenant appealed the finding that it had even breached the Lease in the first place, which was dismissed given the substantially unchanged state of the facts.

Waiver

The action or inaction by a landlord or tenant may constitute a waiver of a breach despite a party's failure to strictly comply with the terms of the Lease. The following two cases provide guidance on how the courts will analyze the available evidence – such as the parties' behavior, an unexecuted agreement, or even a handwritten note – to determine whether there is implied waiver of a lease provision.

In *4439155 Canada Inc. v. Albert Tower Inc.*, the Court of Appeal affirmed the trial judge's finding that the Landlord had wrongly terminated the Lease after the parties had reached an agreement on the amount of arrears owing. Despite the Landlord's incorrect handwritten calculations of the arrears, the Court found that the parties had reached an agreement during their in-person meeting and the Landlord's acceptance of three post-dated checks meant that he had unequivocally waived any additional arrears and was now estopped from changing his mind. As an aside, this case should serve as a **lesson to Landlords** to pay close attention when calculating a Tenant's rental arrears, as subsequent conduct may prevent them from correcting an error.

In *Bayer Inc. v. Belfield Investment Corp.*, the Tenant sought to enforce the terms of an Overholding Agreement and claimed reimbursement from the Landlord for certain amounts owing under the Lease.

The Landlord purported to rely on the Tenant's noncompliance with its end-of-term obligations as set out in the Lease as the basis for refusing to reimburse the Tenant. The Landlord rejected that its obligations were validly modified by the Overholding Agreement because the Agreement was not signed by both the Tenant and the Landlord, which was contrary to the terms of the Entire Agreement clause in the Lease. The Tenant argued that the Landlord's representative waived the requirement to comply with the strict formalities for modifying Lease terms and was estopped from insisting otherwise. The Court found that the Overholding Agreement was validly entered into by both parties and they intended that it would govern the extension of the Lease. The Landlord's actions in signing the Overholding Agreement and then proceeding to act in accordance with it confirmed its acceptance of the Agreement, which effectively changed the Entire Agreement clause and prevented the Landlord from relying on its strict provisions.

Injunctions

Ontario courts are once again reminding us of the flexibility and power of injunctions as a judicial remedy. The strategic timing, effectiveness, and consequences on the parties involved make this remedy unlike any other available remedy in commercial leasing. In *Bloor Street Diner Ltd. v. Manufacturers Life Insurance Co.*, the Tenant sought a permanent injunction for the remainder of its Lease term and any extensions against the Landlord preventing it from redeveloping the Manulife Centre, a 51-storey mixed-use complex in an affluent Toronto neighborhood.

The parties disagreed on the degree of interference arising from the Landlord's proposed construction. The Tenant argued that it would lose all of its natural light and a significant portion of its restaurant seating. The Landlord countered that it would employ every effort to reduce any negative impact on the Tenant's business. The Landlord also argued that the permanent injunctive relief sought was an inappropriate remedy, as monetary damages are both adequate and preferable in these circumstances.

While the Lease provided the Landlord with some rights to redevelop the Building, the Landlord was not permitted to materially interfere with the "flow, continuity, or design" of the Tenant's Premises. The Court found that the redevelopment plans would be too disruptive and isolating to the Tenant and would breach the terms of the Lease that guarantee certain access and visibility rights to the Tenant. In reaching its decision, the Court referred to last year's unreported decision in *1465152 Ontario Ltd. v. Amexon Development Inc.* which held that "where a Tenant alleges wrongful interference with a proprietary interest, an injunction is the preferred remedy."

The court found the Tenant was entitled to:

1. A declaration for specific performance prohibiting construction that adversely affects access, egress, and visibility;
2. A declaration that the redevelopment plans would constitute a breach; and
3. A permanent injunction for the term and any extension thereof.

Limitation Period

The following case is an update from a case we included in last year's article concerning limitation periods. The Ontario Court of Appeal in *Pickering Square Inc. v. Trillium College Inc.* recently found that a new cause of action and a new limitation period arises for each day that a party remains in breach of a continuing obligation. The Landlord brought an action for damages after the Tenant breached the covenant to operate continuously, diligently and actively at all times. The Tenant argued that the action was time barred under the *Limitations Act, 2002*, SD 2002, C.24, Sched. B, because the Landlord had not brought its claim within two years of discovering the breach. The trial court found that the breach was continuous and each day gave rise to a new cause of action, meaning that only a portion of the Landlord's claims was barred and the remaining claims were valid.

On appeal, the Tenant argued that a continuing breach requires a recurrence of distinct acts as opposed to its singular act with continuing effects. The Court dismissed the appeal and found that the trial judge correctly found that there was a fresh cause of action every day that the breach continued. However, given that the limitation period for continuing breaches is calculated on a "rolling" basis, parties will start to lose some of their rights two years after the breach if they're not careful to bring an action promptly.

Landmark Decision

The following landmark decision serves as notice to landlords that being clear and describing terms in unambiguous ways is not only prudent, but also crucial in certain circumstances. A lack of clarity in lease provisions can alter how a lease is interpreted by the tenant and the landlord, which may ultimately trigger a divisive situation between the parties.

The decision in *York Realty Inc. v. Alignvest Private Debt Ltd.* is a warning to landlords that overlooking something as simple as the distinction between prepaid rent and a security deposit can cost a landlord a significant amount of money. This decision indicates that landlords should emphasize clarity over standard form when drafting lease provisions and terms.

Security Deposit or Prepaid Rent?

In *York Realty* the Court considered the distinction between prepaid rent and a security deposit. This distinction depends on both the context and the terms of a Lease, with detrimental consequences for a Landlord if the distinction is not clear. In this case, the Alberta Court of Appeal upheld the lower court's decision in finding that a \$3.2 million deposit from the plaintiff's bankrupt Tenant was a security deposit, not prepaid rent, and required the Landlord to return the money to the Tenant. Under the Lease, the Tenant paid certain prepaid rent, as well as a security deposit which was to be held without interest by the Landlord as security for the performance of the Tenant's obligations. In the event of default, the Landlord could retain the deposit for its own use. The deposit was defined as a security deposit and labeled so on a statement of adjustment. When the Tenant went bankrupt, the Landlord applied for an order that the deposit was actually prepaid rent and thus its property. The defendant, a secured creditor of the Tenant, applied for an order directing the Landlord to remit the deposit to it. The trial court held that the money was a security deposit that fell within the purview of the PPSA, making the Landlord's priority subsequent to the defendant's priority.

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