



Landlords Beware – A Delay in Delivering Possession Could Constitute a Fundamental Breach

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Topics:

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front page

Professional Notes

last page

Firm News

last page

In Spirent Communications of Ottawa Ltd. v. Quake Technologies (Canada) Inc., the Ontario Superior Court of Justice held that the possession date was a fundamental term of a binding agreement to lease and the anticipated six-week delay in delivery of possession from the agreed-upon possession date was considered an anticipatory and fundamental breach of the agreement.

This case involved a lease of office space in a building which was to be constructed by April 30th. The lease term was to commence on June 1st and the landlord agreed to provide the tenant with possession of the demised premises prior to the tenant's intended occupancy date. However, significant construction delays occurred and in mid-April, the tenant received notice from the general contractor that the earliest possible move-in date would be six weeks past the agreed-upon possession date. The tenant claimed anticipatory breach and terminated the offer. The landlord brought a claim to recover amounts owing under the agreement to lease.

Because the tenant was required to vacate its existing premises on May 31st and only in mid-April did it receive notice that its occupancy of the premises was

delayed for a period of six weeks and possibly longer, the landlord was found to be in breach of a stipulation of "major importance" to the agreement. Moreover, in the context of a three-year lease, the court ruled that a six-week delay in the possession date constituted a fundamental breach by the landlord. Not only was the landlord's claim dismissed, the tenant was entitled to treat the agreement at an end and the court awarded damages (of \$122,000 plus interest) to the tenant for costs incurred due to the landlord's failure to meet its fundamental obligation to provide occupancy and the failure to provide notice of the anticipated delay in construction and delivery of the premises in a timely manner.

Is a Commercial Lease primarily a Contract or an Interest in Land?

An appeal to the Supreme Court of Canada (“SCC”) regarding the hybrid nature of a lease was recently abandoned. The decision of the SCC was eagerly anticipated in order to provide additional clarification on whether a commercial lease should be considered primarily a contract or an interest in land. Though dealt with in a number of other cases in other courts, the last time this issue was addressed by the SCC was in the 1971 case of *Highway Properties Ltd. v. Kelly Douglas and Co.* (“Highway Properties”). Prior to Highway Properties, a commercial lease was considered an interest in land despite any contractual provisions included in the lease. In Highway Properties, the SCC ruled that a commercial lease is both a contract and an interest in land.

The case of *Evergreen Building Ltd. v. IBI Leaseholds Ltd.* revisited the issue of whether contractual considerations should take precedence over property-based considerations in determining the type of relief available for breach of a covenant in a commercial lease.

In this case, the landlord notified the tenant that it planned to demolish the (nearly vacant) building containing the tenant’s premises. The lease did not contain a “demolition” clause (or any right of re-entry where the tenant was not in breach of the lease) and the tenant refused to move. The

landlord commenced proceedings for re-entry and a declaration that damages were an appropriate remedy.

In granting injunctive relief (a temporary injunction and later a permanent injunction), the lower court concluded that the lease constituted a demise of land and because there was no right of re-entry to which the landlord was entitled at the time, damages were not an adequate remedy. The landlord appealed and the British Columbia Court of Appeal ruled that the trial judge erred in: (i) rejecting damages out of hand and imposing injunctive relief tantamount to an award of specific performance; and (ii) treating the remedies (related to the lease as a demise and to the lease as contract) as if they existed in water-tight compartments. Instead, the judge should have considered the equities between the parties (including any factors relating to the “uniqueness” of the demised premises to the tenant and the relative hardship of holding the landlord to the strict terms of the lease) in exercising his discretion as to the appropriate remedy. The Court of Appeal explained that “the law in this area has developed on a case-by-case basis with a view to expanding available remedies rather than restricting them.” The court revoked the permanent injunction, reinstated an interim injunction and the remedy issue was remitted to the lower court to be reconsidered.

If the Supreme Court had ruled in favour of the landlord, it could have paved the way for landlords to

Commercial Leasing

The Commercial Leasing Group offers some of the pre-eminent expertise in the field. Our eight-lawyer team acts for developers, lenders, property and asset managers, landlords and tenants of all types of office, industrial and retail properties. Our knowledge of the business aspects of leasing enables us to offer value-added counsel and excellent service in negotiating leases and related agreements, structuring transactions and enforcement of landlord and tenant rights and remedies.

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terminate leases of non-defaulting tenants as long as they are willing to pay adequate compensation.

Is a Mortgage Subject to Prior Rights of Set-Off?

When a mortgagee takes possession of a property, it could be subject to set-off rights that the tenant may have against the landlord. The risks facing a lender came to light in the recent case of *473807 Ontario Ltd. v. TDL Group Ltd.* In this case, the tenant (“TDL”) entered into a postponement and non-disturbance agreement (“PNDA”) with the mortgagee subsequent to entering into the lease. The PNDA did not include language that disallowed any rights of set-off that the tenant may have against the landlord. This became an issue because earlier the landlord had unilaterally tried to evict the tenant and the tenant successfully obtained judgment against the landlord for over \$700,000 in damages. The judgment included an order allowing the tenant to set off the amount of the judgment against rent owing to the landlord. When the landlord defaulted under its mortgage, the mortgagee took possession and the tenant sought to exercise its set-off rights against the mortgagee.

The trial court held that since the mortgagee was not responsible for the wrong done by the landlord, it was not subject to the state of accounts between the landlord and tenant and that TDL could not set off its judgment (obtained against the landlord) against rent.

In allowing TDL’s appeal, the Ontario Court of Appeal interpreted the PNDA as a statement of the parties’ intent that if and when the mortgagee went into possession, the mortgagee would assume the landlord’s position under the lease, subject only to specific exclusions set out in the PNDA. In the absence of specific language to the contrary, the mortgagee (as assignee) takes over the lease “subject to all the equities” that have accrued and is thus bound by the state of accounts as between landlord and tenant. Since the PNDA in this case did not specifically exclude a court-ordered set-off, that set-off award was one of the “equities” that the mortgagee was required to assume.

The moral of the story is that prudent lenders should seek to have their tenants expressly waive all set-off rights against the mortgagee and any subsequent purchaser.

The Use of the Oppression Remedy in Commercial Landlord-Tenant Disputes

The case of *J.S.M. Corp. (Ontario) Ltd. v. Brick Furniture Warehouse Ltd.* (“JSM”) illustrates the broad discretionary powers available to the courts under the oppression remedy provisions of the relevant business corporations statute. In this case, the landlord’s claim against the tenant’s affiliated operating companies was successful, notwithstanding the attempts of the tenant to limit its liability through the use of shell corporations.

In JSM, the defendant shell corporation (“Brick Ltd.”) entered into a lease with the landlord in June 1986. Through a series of transactions and as permitted by the lease, the tenant assigned and subleased its interest in the demised premises to several affiliated entities as follows: Brick Ltd. assigned to “Brick Windsor” (shell corporation), which subleased to “Brick Warehouse” (operating company), which assigned to “Brick Corp.” (operating company). By a consent and acknowledgment dated June 1987, the landlord, Brick Warehouse and Brick Corp. acknowledged that the sublease was in good standing and Brick Corp. covenanted to comply with all of the terms of the sublease. Brick Corp. also agreed to pay all sums due under the sublease and the landlord retained all of its rights under the lease and sublease. A second sublease agreement was executed around March 1988, between Brick Windsor and Brick Warehouse providing the latter with a right of termination upon 90 days notice. The landlord never received notice of, nor consented to this second sublease. The tenant, however, relied on the termination clause in the sublease in vacating the premises. The landlord brought an action for damages for breach of contract, a declaration of oppressive conduct, the tort of inducing breach of contract and intentional interference with contractual and economic interest and misrepresentation.

The court found that the insertion of the termination provision was a fundamental change to a document

that had been consented to by the landlord. Accordingly, such a change required further consent of the landlord, failing which, the sublease was of no force and effect. The tenant was liable for breach of contract and oppressive conduct. It was oppressive and unlawful for the tenant enterprise to first create reasonable expectations and reliance on the part of the landlord that the original tenant would meet its rental obligations through the sublease and then, “through invidious corporation and contractual maneuverings amongst related and affiliated corporations, seek to defeat those reasonable expectations.” The defendants were jointly and severally liable to the landlord for damages equal to the unpaid rent due under the lease between the time when the premises were vacated and the end of the lease term.

Are You Sure Your Right to Renew Is Valid?

Landlord and tenant disputes often arise regarding whether a right of renewal set out in the lease is available. Three recent cases illustrate that the specific language used by the parties in an option to renew the lease or extend the lease term will be interpreted in accordance with the expectations of a reasonable person.

1398955 Ontario Inc. v. O’Shanter Development Co. involved an application to interpret the right to renew contained in the lease, which provided that “the lessee, having at all times faithfully performed all of the terms and conditions of the lease and not being in default, shall have the option to renew...” The lease also required that the tenant pay rent monthly on the first day of each month throughout the term of the lease but the tenant rarely did so.

The tenant argued that the doctrine of “spent breach” should apply. The doctrine states that where a tenant was in breach of a lease at a certain point in time but is no longer in breach at the time the option to renew is exercised, a court may find that the “spent breach” does not prevent the tenant from exercising its option. The court concluded that the doctrine did not apply in this case.

The court held that the word “faithfully” meant “constantly” and, as a result, the tenant was required to establish that it had constantly performed all of the conditions in the lease. Since the tenant’s payment record demonstrated that it had not done so, the tenant was not entitled to exercise the renewal option.

Anthem Heritage Hill Ltd. v. Just One Stop Ltd. (“Anthem Heritage”) dealt with a determination of whether a right to renew set out in a sublease was available to the subtenant. The tenant subleased a portion of its premises to the subtenant. The sublease agreement provided a right of renewal that corresponded to the tenant’s right of renewal in the head lease with two main exceptions: (1) the subtenant was required to give eight months’ notice of its intention to renew, as opposed to the six months in the head lease; and (2) if the tenant elected not to exercise its right to renew the head lease, it was



required to provide the subtenant with notice and the sublease was to be terminated effective on the expiry of the term.

The leased premises were sold and the tenant agreed to surrender its interest in the head lease and provide notice of the surrender to the subtenant. Subsequently, the subtenant notified the transferee-landlord of its intention to renew. In response, an application was made for a declaration that the subtenant was not entitled to renew the sublease.

In affirming the lower court decision, the Alberta Court of Appeal held that “a reasonable person

Up and Coming

The **Commercial Leasing Group** will participate in the 2007 ICSC Canadian Convention at the Metro Toronto Convention Centre on September 24-26, 2007.

Tracy A. Kay is speaking on October 30, 2007 at the Canadian Institute's 7th Annual Advance Forum on Employment Law on "Accommodating Non Disability Needs under the Human Rights Code."

David Louis and **Samantha A. Prasad** will host the seminar "Exit Stage Right: Strategies for Ensuring Smooth Business

Succession" for clients of SBLR Certified Accountants on September 19, 2007. They will also publish the 2nd edition of *Tax and Family Business Succession Planning* with CCH Canadian Limited in the Fall of 2007 and will be hosting a Succession Planning webinar with CGA-Canada in October 2007.

Hartley R. Nathan, Q.C., will publish the 7th edition of *Nathan's Company Meetings and Rules of Procedure* in December 2007.

would conclude that the right of renewal under the sublease would be conditional upon renewal of the head lease." When the head lease was surrendered, the option to renew under the sublease was automatically extinguished.

The court also pointed out that the subtenant had an opportunity to bargain for a covenant from the tenant that such tenant renew its tenancy under the head lease, but the subtenant failed to do so. Similarly, the subtenant could have made a separate agreement with the landlord to lease the premises if the tenant elected not to renew or to surrender its head lease but no such agreement was made. Instead, it relied on the provision that obliged the tenant to give timely notice of its decision not to renew the head lease and therefore did not adequately protect its interests.

The recently decided case of *McDonald's Restaurants of Canada Ltd. v. Grall Corp.* involved a situation where the subtenant successfully took steps to protect its interests by obtaining a non-disturbance agreement ("NDA") to deal with the issues mentioned above in *Anthem Heritage*.

The sublease read as follows: "the [Tenant] hereby covenants to renew the Head Lease as provided therein, in which case the term of this [sublease] shall be automatically extended [...] expiring on November 29, 2011." The NDA entered into by the landlord and subtenant provided that the subtenant was entitled to receive notices of default by the tenant and was permitted to cure the default and assume the head lease or to terminate the head

lease and enter into a new lease directly with the landlord. The NDA further established that "if for any reason the residue of the term of the Head Lease is surrendered by the Tenant [...], the Head Landlord shall enter into a new lease directly with the Subtenant on the same terms and conditions" as contained in the sublease for the term expiring on November 29, 2011.

The key issue in this case was whether the non-renewal of the head lease by the tenant constituted a surrender under the NDA thereby requiring the landlord to enter into a new lease directly with the subtenant, for a term expiring on November 29, 2011. Justice Conway held that an interpretation of the NDA where a non-renewal of the head lease does not amount to a "surrender" is commercially unreasonable, not consistent with the intention of the parties and would lead to unfair results. Such documents are supposed to protect a subtenant and the terms of this NDA indicate an intention to extend such protection for the full term, including any renewals. Furthermore, the tenant was committed under the sublease until November 29, 2011 since the sublease automatically renewed when the head lease was renewed and the tenant was required to renew the head lease. Lastly, the court pointed out that had the landlord been so concerned about excluding non-renewals, they could have easily specified as such. Accordingly, the landlord was required to enter into a new lease with the subtenant on the same terms and conditions as set out in the NDA.

Draft What You Mean – Mean What You Draft

Two recent cases remind us that when developing the wording of lease provisions, particular diligence should be exercised in order to minimize the potential for ambiguity. In the following cases, the court was called upon to interpret provisions that were unclear.

In *Cartareal Corporation, N.V. v. Canada (Minister of Public Works and Government Services)*, the parties entered into a lease with the following right of termination: “the Lessee shall have the right to terminate the lease effective May 31, 2004, upon delivering to the Landlord at least six months prior written notice together with a penalty equal to three months rent.”

On May 17, 2005, the tenant served a notice of termination of the lease to be effective on November 30, 2005 and remitted a penalty payment of three months rent. The landlord’s position was that the tenant had a one-time termination right that was exercisable only on the day six months prior to May 31, 2004 and, therefore, the termination right had expired. The tenant asserted that it had a continuous right to terminate the agreement on any date after May 31, 2004 upon six months notice and payment of the penalty, and, therefore, the termination right was still available.

Justice Dambrot held that the proper interpretation turned on the meaning of the word “effective” which was held to mean “coming into operation.” He adopted the tenant’s interpretation that after May 31st the right to terminate subsisted for the remainder of the lease term. Accordingly, it appears that the word “effective” qualified the termination right as opposed to the termination date. This decision is somewhat surprising and we are of the view that most leasing practitioners would argue that the landlord’s interpretation is more consistent with industry standards and the plain meaning of the words.

Fire Productions v. Lauro involved an appeal regarding the interpretation of the term “fair market rent” as used in the renewal provisions of

a commercial lease. The tenant leased premises that were in need of improvements. The term was a period of three years, subject to four renewal options. The lease provided that all improvements made by the tenant became the property of the landlord upon affixation. Upon exercising its second option to renew, the parties were unable to agree on the rent to be paid. In accordance with the lease, an arbitrator was appointed to determine whether the value of the tenant’s improvements made during the initial term of the lease were to be considered in determining the rental rate during renewal. The arbitrator concluded that the value of the improvements were to be included in the new rent amount. The trial judge reversed this decision, holding that, based on the case law, in the absence of language to the contrary, a tenant’s improvements are not to be taken into account in the calculation of rent.

In rendering this decision, the British Columbia Court of Appeal cited the importance of the word “market” in the term “fair market rent” and found that it could only mean that “the rent to be paid is the rent the premises would attract if exposed to the market at the time of the renewal.” In the court’s opinion, the word “fair” added nothing to the meaning of “market rent.” The court rejected the tenant’s assertion that the parties could not have agreed to include the value of its improvements as it would effectively result in it paying more for the improvements than it paid to acquire them. The tenant had not been disadvantaged on exercising his/her option to renew as it is simply required to pay the rent the landlord would be able to obtain had the lease not been renewed. The arbitrator’s decision was reinstated and the value of the tenant’s improvements was to be considered in calculating rent.

Subrogated Insurance Claims: The Court Analyzes the 1970’s SCC Trilogy

In the 1970s, the Supreme Court of Canada rendered a trilogy of decisions (*Agnew-Surpass Shoe Stores Ltd. v. Cummer-Yonge Investments Ltd.*; *Ross Southward Tire Ltd. v. Pyrotech Products Ltd.*; *Eaton (T.) Co. Ltd. et al. v. Smith et al.*, the “Trilogy”) concerning the rights of an insurer to

bring a subrogated claim in negligence against a tenant for fire damage. The Trilogy decisions stand for the proposition that whether the tenant is liable to the landlord for damages from fire caused by the tenant's negligence must be determined by reference to the lease, not the insurance policy. In those cases, it was held that when a tenant causes a fire in a building that the landlord is obliged under the lease to insure, the tenant has an insurable interest under the landlord's policy and, therefore, a subrogated claim by the insurer against the tenant would be precluded. Two recent cases examined the implications of the Trilogy in a situation where a tenant covenanted to and did pay insurance premiums on policies taken out by the landlord under common area costs. The Manitoba Court of Appeal and the Alberta Court of the Queen's Bench came to seemingly opposite results.

In *Sooter Studios Ltd. v. 74963 Manitoba Ltd.* ("Sooter Studios"), the insurer had paid the landlord under an insurance policy for fire damage which had been caused by the negligence of the tenant. The insurer then commenced a subrogated claim against the tenant. Both the motions judge and the Court of Appeal rejected the tenant's request for summary judgment.

According to the Court of Appeal, the motions judge understood that there is no right of subrogation if the lease provides for the risk of loss to pass to the landlord because the insurer would be standing in the shoes of the landlord. Here, since the lease did not contain an explicit provision that passed the risk of fire damage caused by the tenant's negligence onto the landlord, the insurer was not barred by the lease from bringing the subrogated claim. In reaching his decision, Justice Hamilton pointed out that: (1) the lease did not contain an express covenant of the landlord to insure; and (2) there was an express indemnification and save harmless clause by the tenant in favour of the landlord. In dismissing the appeal, the court rejected the argument that the insurer could not bring a claim against the tenant simply as a result of the tenant paying various landlord expenses, including insurance premiums, under the lease.



In *Alberta Importers and Distributors (1993) Inc. v. Phoenix Marble Ltd.*, due to the negligence of the tenant, a fire had caused considerable damage to the leased premises. Similar to *Sooter Studios*, the tenant paid the landlord's insurance premiums as additional rent under the lease. Furthermore, there was no express covenant by the landlord to insure and there was an indemnity and hold harmless clause by the tenant in favour of the landlord.

Justice Clark cited the *Sooter Studios* decision but came to the opposite conclusion: the absence of an express landlord covenant to insure and the indemnity clause did not constitute an expression in the lease that the tenant should be denied the benefit of its required contribution to insurance premiums. Accordingly, the subrogation claim could not proceed against the tenant. The court concluded that the Trilogy stood for the proposition that once the tenant is obliged to and does in fact pay for the landlord's insurance premiums through additional rent, then the subrogated claim can only proceed if the lease expressly states that the tenant should be denied the benefit of its payments on account of insurance premiums. As a result, the subrogation claim was barred.

These apparently inconsistent decisions leave the law regarding the ability of an insurer to bring a subrogated claim in negligence against the tenant for fire damage unclear. In order for an insurer to have a clear right of subrogation, the lease should expressly set out that the tenant will be denied the benefit of the insurance payments it makes as required by the lease. Alternatively, to clarify that an insurer has no right to bring a subrogated claim, the lease should include an explicit provision passing the risk of fire

..continued on Page 8

Professional Notes

Phillip G. Bevans will teach Business Associations as an Adjunct Professor at Osgoode Hall Law School for the 2007 fall term.

Timothy R. Dunn spoke on "Creditors' Remedies" at the Canadian Institute Debt Recovery Conference held at the Metropolitan Hotel in Toronto on March 26, 2007.

Michael A. Goldberg was quoted in "Flaherty flip sparks confusion," published in the *Financial Post* on March 15, 2007. He was also quoted in the March 21, 2007 *Financial Post* article "Tax move threatens businesses abroad" about the disadvantages of the federal budget proposal prohibiting firms from deducting interest on foreign-related loans.

Kenneth L. Kallish was featured in *LEXPERT Magazine's* April 2007 cover story "Canadian Lawyers Take On the World." The story addressed the growing influence of worldwide legal affiliations in the business community. Ken was also featured in articles discussing the same topic in *Asian Legal Business* and *The Law Times*.

Stephen J. Messinger was featured in *LEXPERT Magazine's* July 2007 cover story "Beyond Bricks and Mortar." He was also featured in the article "Best Lawyers: Real Estate – Cross-border deals spice up practice" on May 30, 2007 in the *Financial Post*. Stephen co-authored the article "How to Get Late-Paying Tenant to Pay Rent On Time," that appeared in the April 2007 edition of the *Shopping Center Management Insider*.

Adam L. Perzow presented "Landlord's Rights and Remedies: Tenant Defaults" at Springfest held at the Metro Toronto Convention Centre on April 13, 2007.

Firm News

Minden Gross LLP is pleased to welcome **William (Bill) M. Lehun** and **Steven I. Pearlstein** to our Real Estate Group, **Brian J. Temins** to our Corporate/Commercial Group and **Rachel B. Goldman** to our Wills & Estates Group to continue their practice. The firm would also like to welcome **Yosef S. Adler**, **Lauren M. Corber** and **Melodie D. Eng** as new associates in our Corporate/Commercial, Leasing and Real Estate Groups, respectively.

Kenneth L. Kallish was named Chairman of Meritas in April 2007. **Meritas** is a global alliance of business law firms of which **Minden Gross LLP** is a member.

Hartley R. Nathan, Q.C., was designated as a Certified Specialist in Corporate and Commercial Law by the Law Society of Upper Canada in July 2007.

Reuben R. Rosenblatt, Q.C., was awarded the 2007 Law Society Medal for outstanding service that reflects the highest ideals of the profession on April 26, 2007.

..continued from Page 7

damage caused by the tenant's negligence to the landlord's insurer. In such a situation, the insurer would be standing in the shoes of the landlord and thus the claim would be barred since the landlord will have assumed the risk for that damage. **MG**

Written by Stephen Posen, Stephen J. Messinger and Christina C. Kobi of **Minden Gross LLP**. Special acknowledgement and thanks to Lauren M. Corber, of **Minden Gross LLP**, for her assistance.

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