Insights and Commentary from Dentons

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INTRODUCTION

The topic of “rights and remedies in the event of defaults” in the context of a commercial lease, is exceedingly broad and can cover a wide array of issues from both the perspective of the landlord and the tenant. The usual landlord-tenant relationship results in the negotiation of a document, a lease, which contains many obligations and responsibilities on the part of the tenant, and fewer obligations and responsibilities on the part of the landlord. At the same time, the lease is likely to contain detailed provisions setting out the circumstances in which a tenant will be considered to be in default of its obligations, together with an outline of the rights available to the landlord in such circumstances. The lease likely does not contain many obligations or responsibilities on the part of the landlord, or set out the remedies available to the tenant if the landlord does not perform its obligations.

In a healthy landlord-tenant relationship, the landlord and tenant will deal with each other in the event of a default so that they can work out their problems and maintain a strong landlord-tenant relationship. If the parties find it necessary to resort to their strict rights and remedies as set out in the lease or at law, their relationship is in serious peril. Nevertheless, it is important for both parties to set out in the lease document the rights and remedies available to them in the event of the default of one of the parties. It should be recognized, however, that with the exception of the very strong tenant, the industry practice is such that it is not likely that the lease will contain specific remedies available to the tenant for the default of the landlord. In this case, the tenant must look to the common law to determine if a landlord’s default is fundamental to the landlord-tenant relationship or not.

CHARACTERIZATION OF TENANT’S DEFAULTS

The rights and remedies available to a landlord upon the default of a tenant vary considerably depending on the nature of the default in question. Generally speaking, defaults can be characterized as monetary defaults or non-monetary defaults.
Monetary defaults are those defaults which relate to the non-payment of rent. It is important to determine, based on the terms of the lease, what constitutes rent. In addition to the basic rent, a tenant is usually also required to pay its share of operating costs, taxes and utilities. Payment of some of the foregoing costs, or of other costs, may be required to be made by the tenant directly to third parties rather than to the landlord. A lease should characterize all of these amounts (whether paid to the landlord or to a third party) as rent, or additional rent, in order to ensure that those remedies that pertain to the recovery of rent will be available. Section 136(1) of the *Bankruptcy and Insolvency Act* (the “BIA”) provides that when a tenant becomes bankrupt the landlord has the right to accelerate rent for a three-month period (if the lease provides for this acceleration) and will rank as a preferred creditor for accelerated rent (but only to the extent of the realization of the tenant’s assets located on the leased premises at the time of the bankruptcy). Accordingly, the wider the definition of rent, the larger the landlord’s preferred claim would be.

The remedies made available to the landlord for default in the payment of rent are broader than the remedies available for default in payment of monetary obligations not characterized by the lease as rent, or for non-monetary obligations. For example, in s. 18(1) of the *Commercial Tenancies Act* (the “CTA”), no notice is required for a landlord to re-enter if rent remains unpaid for 15 days after the due date, unless agreed to otherwise in the lease. By contrast, s. 19(2) of the CTA requires that reasonable notice, together with an opportunity to remedy (and other specified technical requirements which will be referred to below) be given before a landlord is entitled to exercise its right of re-entry or forfeiture for the breach of a non-monetary obligation under the lease. Most leases today deal specifically with the notice issue and provide that either no notice is required for the landlord to exercise its rights as a result of the non-payment of rent, or that the tenant is entitled to a specified notice period prior to the landlord being entitled to exercise its rights as a result of the non-payment of rent. However, the parties cannot contract out of the requirements of s. 19(2) of the CTA (for a further discussion on requirements under s. 19(2) of the CTA, see comments under the heading “Remedies where the Landlord wishes to Terminate the Lease”). As well, the right of distress is only available to the landlord in connection with the non-payment of rent (unless a non-monetary default becomes a monetary

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2 R.S.C. 1985, c. B-3 [BIA]
3 R.S.O. 1990, c. L.7 [CTA]
default by the specific provisions of the lease which allow the landlord to recover damages, or the cost of remediying tenant defaults, as additional rent).

Note that a tenant has the entire day on which the rent is due to make payment of the rent (unless otherwise agreed) and therefore, rent is in arrears only after midnight the day rent is due.⁴ A tenant is in default in the payment of rent on the first day, but would not be considered to be in arrears until the second day. Consequently, if a lease requires that rent be in arrears for 15 days before the landlord can exercise its rights, the landlord may not exercise its rights until the beginning of the 17th day (assuming the parties have not agreed otherwise), whereas if the landlord is entitled to exercise its rights once the tenant has been in default for 15 days, the landlord would be entitled to exercise his or her rights on the 16th day.

While many lease forms today provide that the landlord will give the tenant notice of its default in the payment of rent before the landlord exercises its rights and remedies, a landlord may wish to provide that its obligation to provide such notice will be limited to a specified number of defaults. Otherwise, a tenant could be late in paying the rent every month, but the landlord would still be required, if it has agreed to give notice, to give the tenant notice each month before exercising its rights. The tenant could therefore delay the payment of rent each and every month. In the circumstances, the landlord may wish to provide that it will only be required to give notice for non-payment of rent once or twice in every 12-month period, but thereafter would be entitled to exercise its rights without further notice.

OPTIONS AVAILABLE TO LANDLORDS ON TENANT’S DEFAULT

As a preliminary matter, a landlord faced with a tenant in default (whether monetary or non-monetary) must decide how it wishes to proceed. The landlord may wish to preserve the lease (“keep it alive”), or may prefer to terminate the lease by exercising its right of re-entry and forfeiture. The nature of the default is key in deciding how the landlord wishes to proceed. See the chart at the end of this chapter for an overview of the possible remedies available upon default.

Remedies where the Landlord wishes to Preserve the Lease

Monetary Defaults

Distress

Distress is a summary remedy entitling the landlord to seize, take possession of, and sell goods, chattels and inventory of the tenant on the premises to satisfy arrears of rent. Unless otherwise provided for in the lease, this remedy can be exercised without prior notice to the tenant (but note that in August 2000, the Ontario Ministry of Consumer and Commercial Relations set out a proposal in a consultation paper entitled “Consumer Protections for the 21st Century” which would have required prior notice to a tenant if the landlord intends to render a distress. This proposal did not become law). Distress is a self-help remedy available to a landlord without the need to resort to the courts.\(^5\) It is most important to realize that distress is considered an incident of the landlord-tenant relationship and consequently cannot be exercised if the lease has been terminated.\(^6\) This remedy arises at law and does not have to be provided for in the lease, and it is premised on the continuation of the lease.\(^7\)

The right of distress arises at common law and also is provided for in the CTA.\(^8\) As a precondition to the right of distress, there must be a landlord and tenant relationship, the tenant must be in possession of the premises, and there must be arrears of rent due and payable to the landlord. A landlord exercising its right to distrain must be extremely cautious, as an illegal distress\(^9\) (which would render the distress void) or an irregular distress\(^10\) (a distress which is legally effective, but renders the landlord liable to the tenant for damages arising out of the irregularity) could render the landlord liable for damages. Amongst the many formalities relating to distress, are the following:

(1) Distress can only be effected after dawn and before sunset, and cannot be effected on a Sunday.\(^11\)

(2) While there is no requirement to give prior notice of the distress, proper notice must be given to the tenant at the time the distress is taken.\(^12\)


\(^6\) Ibid., at p. 85.

\(^7\) Ibid., at p. 86.

\(^8\) CTA, ss. 30-57.


\(^10\) Ibid.

(3) All goods, chattels and inventory of the tenant, occupant or other subtenant that are found on the premises are subject to distress, but goods, chattels and inventory belonging to persons other than the tenant (such as goods belonging to the spouse, daughter, son, daughter-in-law, or son-in-law of the tenant or any other relative of the tenant) may not be distrained unless those persons have derived title to the property from the tenant.13

(4) Distress must be reasonable — a landlord is only entitled to seize sufficient goods to satisfy the amount of rent in arrears and the costs of the distress. The landlord will be liable to the tenant in damages if it seizes more goods than it reasonably should have.14

(5) Force cannot be used to enter the tenant’s premises in order to effect a distress.15

(6) After the landlord has taken possession of the goods (by actually removing them from the premises and storing them elsewhere, or tagging the chattels which are being seized, or posting a distress notice on the premises (constructive distress), the landlord must wait five days, have the goods appraised by two separate independent appraisers and then the landlord may sell the goods and apply the proceeds on account of arrears of rent.16 The landlord may also be liable in trespass if it does not sell the goods within a reasonable time of the seizure.17

(7) The goods sold by the landlord must be sold “for the best price that can be got for them”18 and case law has determined that the landlord does not have the right to buy or have its agent buy the goods that are the subject of the distress.19

(8) After satisfying all arrears of rent, paying the costs of distress, appraisal and the sale, the landlord must account to the tenant for the balance of any proceeds.20

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12 CTA, ss. 34(1) and 36.
13 CTA, s. 31(2).
16 CTA, s. 53.
17 Lynch v. Bickle (1867), 17 U.C.C.P. 549.
18 CTA, s. 53.
20 CTA, s. 53; see also Pettit v. Kerr (1889), 5 Man. R. 359 (C.A.) and Robinson v. Shields (1865), 15 U.C.C.P. 386.
It should be noted that the landlord may not sue for rent as long as the distress has not been completed (i.e., the goods have been appraised and sold). If, however, a deficiency remains after the goods subject to the distress have been sold, the landlord may sue for the deficiency, or may terminate the lease for arrears of rent as a result of the fact that there is a deficiency remaining.

An illegal distress occurs where the distress is executed in circumstances where there was no basis for exercising the remedy in the first place. Where the distress is illegal, the whole procedure is void ab initio and the landlord is considered to be a trespasser on the tenant’s premises. In these circumstances, the tenant would be entitled to recover from the landlord the full value of the goods seized and any damages incurred by the tenant as a result of the seizure. Examples of an illegal distress include a distress where there is no landlord and tenant relationship, where there is no rent in arrears, where the landlord enters the premises during a period in which distress cannot be undertaken (before dawn, after sundown or on Sunday), or there is a substantial delay in appraising and selling the seized goods. Section 55(2) of the CTA entitles the tenant to recover all damages sustained as a result of the illegal distress. A distress is considered to be irregular when the landlord breaches the requirements with respect to the form of distress. Examples of an irregular distress would be those in which the landlord breaches some of the technical requirements of the CTA, for example those requiring the distress to be reasonable, the requirements to obtain the proper appraisals, make an inventory of the property or give a copy of the demand, costs and expenses to the tenant, or sell the seized goods within the five-day period. Section 54 of the CTA gives the tenant the right to claim “special damages” where the distress is irregular.

As has previously been indicated in this chapter, the right to distrain is an incident of the landlord and tenant relationship, and therefore, there must be an ongoing landlord-tenant relationship for the landlord to be entitled to exercise its rights of distress. A landlord cannot distrain, and terminate the lease at the same time, as the landlord could then be held liable in damages for an illegal distress. Case law has historically

24 Ibid.
25 Ibid.
provided that a landlord may not change the locks on the door in conjunction with the distress, since changing the locks and excluding the tenant from the premises is effectively a termination of the lease which results in the landlord losing its right to distress.27 However, landlords have become much more creative over time as they have sought to preserve the goods and chattels which are being distrained while maintaining the tenancy. For example, if the landlord wishes to change the locks at the same time that it exercises its right of distress, it must give the tenant notice stating specifically that it is not terminating the lease, but that the locks have been changed to protect the goods and that the tenant may have free access to the premises.28 In order for this to be effective, the landlord should ensure that the tenant is entitled to unlimited access to the premises by, for example, providing the phone number of a contact person who will arrange for the doors to be opened at any time the tenant requires. If the tenant requires access to the premises for an extended period of time, the landlord may wish to hire a security guard to ensure that the goods and chattels which are subject to the distress are not removed. A tenant that removes goods which are subject to a constructive distress would be liable to the landlord for damages. As a result, cases in recent years have held that in limited circumstances (generally speaking, when it is not possible to physically remove the goods from the premises), a landlord may change the locks while distraining without rendering the distress illegal.29 A practice has developed whereby the distraining party posts a notice at the tenant’s premises stating that: (a) the landlord is distraining for rent arrears against the tenant’s goods and locked the premises solely to protect the goods from removal by others;30 (b) the tenant is entitled to access to the premises on contacting the landlord or his or her agent;31 and (c) the tenancy has not been forfeited.32 The courts have endorsed this practice so long as the

31 Supra, footnote 21, at p. 36.
32 Supra, footnote 29.
tenant is granted access to the premises on request.\textsuperscript{33} If the distraining party refuses access to the tenant, the landlord has terminated the lease.\textsuperscript{34}

While this chapter will not deal with the effects of the tenant’s bankruptcy on the landlord’s remedies in any detail, landlords should be aware that a completed distress, which includes the payment to the landlord of proceeds from the sale of seized goods of the tenant, may not necessarily entitle the landlord to these proceeds if the tenant becomes bankrupt within three months of the completion of the distress.\textsuperscript{35}

Distraining landlords should also be aware of potential personal liability associated with selling distrained goods. The Province of Ontario revised the \textit{Retail Sales Tax Act}\textsuperscript{36} to impose a penalty on creditors who seize assets of a debtor who is liable to remit taxes under this statute. The revised s. 22 of the \textit{Retail Sales Tax Act} provides that if the seizing creditor does not obtain a tax clearance certificate from the Ontario Ministry of Finance prior to selling the goods seized, the seizing creditor becomes personally liable for all unpaid retail sales taxes, interest and penalties owing by the debtor effective from January 1, 1998. It is also important to note that the personal liability imposed on the seizing creditor is not limited to the value of the property seized. As a result, a distraining landlord should not proceed to sell any goods under distress without first obtaining a Retail Sales Tax Certificate.

Finally, landlords should be aware of Part II of the CTA,\textsuperscript{37} which provides tenants who wish to dispute the right of the landlord to distrain with a mechanism to bring issues before a judge with broad judicial jurisdiction to determine questions between the parties on a summary basis.\textsuperscript{38}

\textit{Action for Rent}

Although a landlord has the right to terminate a lease and claim damages for future losses (discussed below),\textsuperscript{39} a landlord may still wish to sue for damages (i.e., the arrears) without terminating the lease. One such situation could be where the landlord has a mortgage in which it has covenanted not to terminate leases without the mortgagee’s consent. A landlord may commence an action for arrears of rent and, in accordance with the \textit{Rules of Civil Procedure},\textsuperscript{40} the claim may be for arrears of rent at

\begin{footnotes}
\item[33] Ibid.
\item[34] Supra, footnotes 28 and 29.
\item[37] CTA, Part II, s. 66.
\item[38] Mundell v. 796586 Ontario Ltd. (1996), 3 R.P.R. (3d) 277, 64 A.C.W.S. (3d) 679, additional reasons re costs 65 A.C.W.S. (3d) 115 (Ont. Ct. (Gen. Div.)).
\end{footnotes}
the date of issuing the statement of claim and for rent accruing due in the
future, up to the date of trial. A clear advantage to the landlord in suing for
rental arrears in this manner, without terminating the lease, is that the
landlord may therefore not have a duty to mitigate its losses (as it appears
to be required to do if it terminates the lease — see below). As a practical
matter, if there is a dispute with the tenant regarding amounts owing, the
landlord is also reducing its exposure to a claim by the tenant for wrongful
termination if it proceeds in this manner.

Non-Monetary Breaches

The landlord may not wish to terminate a lease for the breach of a non-
monetary covenant, for example, a breach of the covenant to repair the
premises or the covenant to keep the premises clean and tidy. In these
circumstances, in particular if the tenant is paying the rent in a timely
manner, the landlord would likely prefer to require the tenant to comply
with its obligations under the lease. Most leases would entitle the landlord
to perform these obligations on the tenant’s behalf, and to require the
tenant to reimburse it for the reasonable costs incurred in doing so.
Assuming that the lease provides that all monies owing to the landlord are
additional rent, the tenant’s failure to reimburse the landlord for these
costs would result in a monetary default on the part of the tenant, in which
case all of the remedies referred to previously in this section would be
available to the landlord. Depending on the nature and seriousness of the
default, the landlord may attempt to obtain an order for specific
performance, injunctive relief41 or a mandatory order,42 but the courts
are usually reluctant to grant this relief, as courts do not wish to be put in a
situation in which enforcement requires the court’s supervision.43 In these
circumstances, the landlord will, as a practical matter, be restricted to an
award of damages.

(3d) 87 (B.C.S.C.) (The court granted injunctive relief compelling a tenant to continue to
operate its store. In this case the court was not concerned with the supervision and
enforcement of an injunction as Safeway had sophisticated systems in place).
42 A.L. Sott Financial (Newton) Inc. v. Vancouver City Savings Credit Union
(2000), 72
B.C.L.R. (3d) 383, 31 R.P.R. (3d) 56 (B.C.C.A.) (The court stated that although
mandatory injunctive relief is rare and was not granted in this case, it is possible that
mandatory injunctive relief could be granted under different circumstances).
43 Bramalea Ltd. v. Canada Safeway Ltd. (1985), 4 C.P.C. (2d) 144, 37 R.P.R. 191 (Ont.
H.C.J.) and Lackner Centre Developments Inc. v. Toronto-Dominion Bank
(1993), 17
C.P.C. (3d) 60, 32 R.P.R. (2d) 204 (Ont. Ct. (Gen. Div.)).
Remedies where the Landlord wishes to Terminate the Lease

The Notice Requirement

If the landlord determines that it wishes to terminate the lease, the landlord must first ensure that any notices required to be given pursuant to the lease or the CTA are properly prepared and served on the tenant. The provisions in the lease setting out the manner in which notice is to be given to the tenant must be strictly adhered to.

Section 18(1) of the CTA provides that for monetary default, “no formal demand” is required before the landlord is entitled to exercise its right to re-enter if the rent remains unpaid for 15 days. Often, however, the default provision of the lease will deal specifically with notice for monetary breaches, and either provides that no notice is required, or that a shorter specified notice is required.

With respect to non-monetary breaches, s. 19(2) of the CTA requires that the landlord give to the tenant notice which satisfies the requirements of s. 19(2) of the CTA. Section 19(2) of the CTA specifically provides that the right of re-entry or forfeiture with respect to a non-monetary covenant is not enforceable unless: (a) the landlord has served on the tenant a notice, which notice must specify the particular breach complained of and, if the breach is capable of remedy, require the tenant to remedy the breach; in either case, the notice must require the tenant to make compensation in money for the breach; and (b) the tenant has failed within a reasonable time thereafter to remedy the breach, if it is capable of remedy, and to make reasonable compensation in money to the satisfaction of the lessor for the breach.

Notwithstanding this statutory requirement, the courts have indicated that compensation need not be requested in circumstances in which damages would not be an appropriate remedy — see Chick ’N Treats Inc. v. Woodside Square Ltd. (1990), 38 O.A.C. 138, 23 A.C.W.S. (3d) 209 (Ont. C.A.) (in our opinion, the additional requirement that the lessee make compensation for the breach cannot be mandatory, because the resulting obligation on the lessee to make reasonable compensation to the satisfaction of the lessor would be nonsense in situations, such as this in the case on appeal, where the breach is not quantifiable. We believe that it is a requirement of the Notice if the landlord requires compensation in addition to remedying the breach, but it is one that can be waived); ARC Sports Ltd. v. Delia Catering Inc., [1997] O.J. No. 3790 (QL), 74 A.C.W.S. (3d) 283 (Ont. Ct. (Gen. Div.)) (the compensation provisions in this section are...
time after receipt of the notice to remedy the breach and to make reasonable compensation for the breach. Failure to serve notice on a tenant pursuant to s. 19(2) of the CTA could result in the landlord being held liable for damages in trespass and for wrongful termination of the lease. As a general matter, courts are very reluctant to sanction forfeitures, and there are, therefore, numerous cases in which purported forfeitures have been invalidated by the courts for what might be considered to be minor breaches of the strict provisions of s. 19(2) of the CTA.

In *Mount Citadel Ltd. v. Ibar Developments Ltd.*, Estey J. suggested that the parties to a lease could contract out of the provisions of s. 19(2) of the CTA, and in the case of *Royal Inns Canada Estate (Trustee) v. Bolus-Revelas-Bolus Ltd.* Hollingworth J. cited the *Mount Citadel* decision to support the proposition that the parties can contract out of the provisions of s. 19(2) of the CTA. It should be noted, however, that the remarks in both of the above mentioned cases are *obiter* and while there has not been a subsequent decision which clearly states that there is not a right to contract out of s. 19(2) of the CTA, the better view appears to be, based on the numerous cases dealing with relief from forfeiture, that the parties cannot contract out of s. 19(2) of the CTA. The public policy behind s. 19(2) of the CTA is that a tenant’s leasehold interest should not be subject to termination for a non-monetary breach of which a tenant may not be aware without giving the tenant a reasonable period of time within which to cure the default. In addition, s. 18(1) of the CTA applies to every lease, whether in writing or not, “unless it is otherwise agreed”, whereas in s.

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49 (1976), 73 D.L.R. (3d) 584, 14 O.R. (2d) 318 (Ont. H.C.J.) (“*Mount Citadel*”).


52 See *780046 Ontario Inc. v. Columbus Medical Arts Building Inc.*, ibid.
19(2) of the CTA it is provided that a right of re-entry or forfeiture is not enforceable . . . unless notice meeting the requirements of that section is served on the tenant.

The landlord should also consider whether it has agreed or it is desirable to give notice to other persons of a tenant’s default. Examples include a leasehold mortgagee, the holder of a security interest on the tenant’s equipment or inventory, any guarantor or indemnifier of the lease and any construction lien claimant. Landlords are often not aware of the provisions of the Construction Lien Act,53 (the “CLA”) and in particular s. 19(2), (3) and (4) of that Act which require a landlord to give to every person who has registered a lien claim against title to the premises, written notice of the landlord’s intention to terminate the lease for non-payment of rent and the amount of the arrears claimed. The lien claimant then has 10 days to pay the amount of the arrears, which amount can then be added to the amount of the lien claim. Although the CLA does not set out a penalty if the landlord fails to notify a lien-holder of its intention to terminate the lease, a termination by a landlord would be invalid for failing to provide this notice.54

Finally the landlord should ensure that it has not been informed of any insolvency proceedings of the tenant which could include a stay order. Generally, an order under the Companies’ Creditors Arrangement Act,55 a proposal under the BIA and the court appointment of a receiver of the tenant’s assets will include a general stay of actions against the debtor/tenant.

Right of Re-Entry and Forfeiture

In order to exercise its right to re-enter and terminate the lease, the landlord must proceed in one of four ways:

1. physically re-take possession of the premises by actually obtaining possession of the premises, and ensure that the tenant is deprived of its use of the premises56 (such as by changing the locks);
2. apply for and obtain an order under Part III of the CTA that the lease has been terminated and the tenant is required to vacate the premises (when proceeding under Part III, arrears of rent cannot be claimed); or
3. commence a court action for possession of the premises — this is a more formal proceeding and involves the issuance of a statement of claim. If an action is contested, however, the process is very

56 Kavanagh v. Gudge (1844), 7 Man. & G. 316.
costly and time-consuming as the usual court process can be invoked, thus resulting in the exchange of pleadings, discoveries and a lengthy wait for a court date. An action for possession may be combined with an action for arrears of rent;

(4) enter into a written termination agreement with the tenant pursuant to which the parties agree that the tenancy has been terminated.

A landlord should be careful to ensure that it does not inadvertently waive its right to terminate the lease by taking any steps pursuant to which it is deemed to have waived the right to terminate. For example, accepting rent that would have been due after the breach or after the termination of the lease, suggests that the landlord continues to recognize the existence of the lease and by accepting such rent the landlord would be deemed to have waived its right to terminate the lease.57

There is also the possibility that at some time after termination of the lease, the tenant will apply for relief against re-entry or forfeiture.58 There is no deadline for filing this application; the tenant must apply “within reasonable time” after the termination of the lease,59 what is “reasonable” will depend upon the circumstances. Courts will always apply equitable principles in an application for a relief from forfeiture.60 In most cases if the tenant applies for relief and is able to pay the full amount of the arrears, then barring any grave prejudice to the landlord, the courts will grant relief and allow the tenant to re-claim the premises.61 However, where the tenant has wilfully violated the terms of the lease62 or where the tenant’s conduct was “reprehensible, substantial and persistent”,63 courts have refused the tenant’s request for relief from forfeiture.

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57 Central Estates (Belgravia) v. Woolgar (No. 2), [1972] 1 W.L.R. 1048; see also C.A.W. Bentley, M.J. Butkus and J. McNair, Williams and Rhodes Canadian Law of Landlord and Tenant, 6th ed. (Toronto: Carswell, 1988) (looseleaf), at 12:8:3, for a review of cases dealing with waiver.
58 CTA, s. 20(1) and (4); Courts of Justice Act, R.S.O. 1990, c. C.43 and the inherent power and jurisdiction of the court to declare relief from forfeiture in all contracts; see also H.M. Haber, Q.C., Tenant’s Rights and Remedies in Commercial Lease: A Practical Guide (Aurora: Canada Law Book, 1998), at pp. 197-218.
59 CTA, s. 19(2).
Damages and Other Remedies Available to the Landlord

The unanimous 1971 Supreme Court of Canada decision in *Highway Properties Ltd. v. Kelly, Douglas & Co.* completely changed the manner in which leases are viewed, and in particular, the remedies available to a landlord in the case of a default of the tenant. Prior to the *Kelly Douglas* case, the Canadian law in this area was set out in the Ontario Court of Appeal decision of *Goldhar v. Universal Sections and Mouldings Ltd.* In *Goldhar*, the Court of Appeal was of the view that there could not be a claim by a landlord for prospective damages following abandonment by the tenant because the claim would have to be based on rights accruing under the lease, and once the lease had been terminated all rights under the lease would be at an end. The Court of Appeal, therefore, was of the view that the only way to claim for prospective damages would be to keep the lease alive by notifying the tenant that the landlord would attempt to re-let the premises on the tenant’s behalf. In contrast, in the *Kelly Douglas* case, the court held that the lease could be terminated and the landlord could still recover damages for losing the benefit of the lease over its unexpired term and that the landlord could claim for damages for loss of future rent for the unexpired term of the lease (less the actual rental value of the premises over the term). Perhaps the most important statement in the *Kelly Douglas* case is that of Laskin J.:

> There are some general considerations that support the view that I would take. It is no longer sensible to pretend that a commercial lease, such as the one before this Court, is simply a conveyance and not also a contract. It is equally untenable to persist in denying resort to the full armoury of remedies ordinarily available to redress repudiation of covenants, merely because the covenants may be associated with an estate in land. Finally, there is merit here as in other situations in avoiding multiplicity of actions that may otherwise be a concomitant of insistence that the landlord engage in instalment litigation against a repudiating tenant.

While the *Kelly Douglas* case dealt specifically with circumstances in which a tenant abandoned the premises, it is now accepted that a landlord may claim for these same future damages whether the tenant’s breach of the lease results from a repudiation of it or from some other default.

The *Kelly Douglas* case did not definitively deal with a number of issues of concern to landlords. Amongst those are the following:

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66 Supra, footnote 64, at p. 576.
Notice — Laskin J. stated in his written decision that the landlord could terminate the lease with notice to the defaulting tenant that damages would be claimed on the basis of the present value of damages for losing the benefit of the lease over its unexpired term. This comment has led to findings in subsequent court decisions that the landlord must notify the tenant at the time it decides to terminate the lease that it intends to claim damages based on the present recovery for the loss of the benefit of the lease over its unexpired term. However, North Bay T.V. & Audio Ltd. v. Nova Electronics Ltd., Rutherford J. expressed the view that while notice must be given, it need not be given contemporaneously with the taking of possession by the landlord. In that case, the landlord notified the tenant of its intention to claim losses for prospective rent by issuing a claim approximately one-and-a-half months after the lease was terminated, and the court determined that the issuance of the claim was sufficient notice. In the case of Globe Convestra Ltd. v. Vuetic, Taliano J. held that no notice was required. This view that notice is not required before the landlord is entitled to claim for prospective rent is also more consistent with the view of the lease as a contract, as claimants in contract disputes are not required to provide notice before claiming. In the year 2000, the British Columbia Court of Appeal considered the timing and wording of the Kelly Douglas notice. In Langley Crossing Shopping Centre v. North-West Produce Ltd., the tenant argued that by terminating its lease without prior or contemporaneous notice of its intention to claim against it for prospective damages, the landlord had lost its right to pursue that remedy. The trial judge held that the landlord gave sufficient notice in two letters, which demanded payment for all currently outstanding arrears, failing which it would enforce its rights under the lease. Applying the North Bay T.V. case, the trial judge held that the Kelly Douglas notice did not have to be given on or before termination, but could be given after termination as part of the actual pleadings. The British Columbia Court of Appeal allowed the appeal and held that it is not sufficient for a landlord to give general notice of its intention to exercise its rights under the lease — the landlord must make clear which of the four “mutually exclusive” remedies listed in Kelly Douglas it proposes to follow. In obiter, Esson J. suggested that those cases which found that notice delivered after the termination was sufficient may have been

due to the particular circumstances of those cases and the fact that
the tenants had already “walked out” and therefore prior notice
could not be given.

(2) Mitigation of Damages — Prior to the Kelly Douglas case,
landlords did not have a duty to mitigate their losses as a result of
a tenant’s abandonment of its premises as mitigation was a
concept of contract law and consequently not applicable to
breaches of leases. If the result of the Kelly Douglas case was that a
commercial lease is to be viewed only as a contract, it would
follow that a landlord would be required to mitigate its damages
after a tenant has clearly repudiated its lease. However, in the
Ontario decision of 607190 Ontario Inc. v. First Consolidated
Holdings Corp.,

Then J. stated:

In my opinion, on the facts of this case, the landlord exercised the
first remedy made available to him upon the tenant’s repudiation of the
lease as set out in the decision of the Supreme Court of Canada in
Highway Properties...[h]aving done so, I agree with Master Donkin that
there was no duty upon the landlord to mitigate.

First Consolidated Holdings was followed in Fred T. Reisman &
Associates Ltd. v. Issa. This issue was also discussed by Taylor J.
with the British Columbia Court of Appeal in Transco Mills Ltd.
v. Perscan Enterprises Ltd., where he stated:

There is in my view no basis on which a landlord of commercial
premises can be required to mitigate its loss where it maintains the lease
in existence and claims for rent due.

...the tenants argue, in the face of what seems to be the rule, that
there is a duty of mitigation even where the lease remains alive.

Because the present claims appear to be clearly to be for rent, not for
damages, I agree with the trial judge that, as the law now stands, no duty
to mitigate can arise.

A landlord’s duty to mitigate upon repudiation of a commercial lease by
a tenant can be summarized as follows:

71 (1992), 60 O.A.C. 285, 26 R.P.R. (2d) 298 at p. 306 (Ont. (Div.Ct.)) (“First Consolidated
Holdings”).
(1) A landlord is under no duty to accept such repudiation or to terminate the lease and mitigate its damages. Instead, the landlord can do nothing at all with respect to the tenancy and sue the tenant from time-to-time for unpaid rent reserved (*Kelly Douglas, First Consolidated Holdings, Transco Mills Ltd.*).

(2) Even if the landlord chooses not to terminate the lease, any mitigation in fact, provided that such mitigation is truly consequential to the breach,\(^74\) will reduce any recovery of rent to which the landlord is otherwise entitled.\(^75\)

(3) If the landlord chooses to terminate the lease on account of such repudiation and seeks damages thereafter, then the landlord must seek to mitigate its damages.\(^76\)

(4) Pursuant to an agreement to lease, especially where possession has not been conveyed, a prospective landlord may be under a duty to mitigate where a prospective tenant under such an agreement to lease repudiates the agreement to lease.\(^77\)


Other Options Available to the Landlord

In addition to the tenant, there are often others who directly or indirectly may be liable on the lease upon default. A landlord should consider some of the following possibilities:

(1) **Guarantees, Indemnity Agreements and Letters of Credit** — If a landlord has doubts as to the financial status of a tenant, promises to pay or perform obligations under the lease are often demanded from third parties. Letters of credit can be obtained for any amount of money that relates to rental obligations under a lease. These forms of security are essential where a tenant goes bankrupt. Upon bankruptcy of the tenant, the landlord is limited to a preferred claim for up to three months of arrears of rent prior to the bankruptcy and three months of accelerated rent (if the lease specifically provides for such accelerated rent in the event of default, but only to the extent of the realization of the tenant’s

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assets located on the leased premises at the time of the bankruptcy). However, a landlord may be able to protect against this result where there is effective security in place.

The seminal case of *Cummer-Yonge Investments Ltd. v. Fagot*, established that a guarantee would be of little use on bankruptcy of the tenant and subsequent disclaimer of the lease; whereas an indemnity agreement would have a greater chance of survival if it was well drafted. Courts applied this principle to cases involving letters of credit resulting in serious doubt being cast on the viability of this form of security. However, the Supreme Court of Canada in the case of *Crystalline Investments Ltd. v. Domgroup Ltd.*, overruled *Cummer-Yonge* noting that the decision had created uncertainty in leasing and bankruptcy by forcing drafters of leases to try and circumvent its holding “by playing upon the primary and secondary obligation distinction and performing ‘tortuous distinctions’ in order to re-impose liability on guarantors”. *Crystalline* appears to have changed the applicable law in this area. The guarantor’s liability for a tenant’s obligations under the lease are no longer extinguished on the disclaimer of the lease.

*Crystalline* and post-*Crystalline* decisions indicate an increasing tendency to uphold landlord’s security. However, it may be premature to dismiss the rule in *Cummer-Yonge*. Therefore, comprehensive drafting of these forms of security remains critical. For a further discussion on this

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78 BIA, s. 38 and CTA, s. 38(1).
83 Ibid., at para. 39.

(2) **Original Tenant** — If the lease was assigned to the defaulting tenant and the original tenant was not released, then the original tenant will still be liable even if the assigned lease has been disclaimed by a trustee in bankruptcy of the assignee/tenant.\(^\text{87}\) For a further discussion on this and other related issues see the chapter entitled: “Transfers of Lease — Assigning, Subletting and Change of Control” by Stephen Posen.

(3) **Realize on Other Security** — Obtaining some security is important especially if the landlord is giving large inducements or allowances, rent-free periods, loans or other such concessions to a tenant. Becoming a secured creditor is much more advantageous to a landlord in the event of a tenant’s bankruptcy; being unsecured leaves a landlord behind secured creditors with respect to any claim for arrears or accelerated rent from the tenant’s estate although it does have “preferred” status ahead of all other unsecured creditors. A tenant can grant security on its valuable assets in the premises and elsewhere (i.e., fixtures, equipment, accounts receivable, etc.). The landlord must protect its position by entering into a security agreement and registering or perfecting its security interest pursuant to the *Personal Property Security Act*.\(^\text{88}\) For a further discussion on this and other related issues see the chapter entitled: “Guarantees, Indemnities, Letters of Credit, Security Deposit and Landlord Security” by Stephen Posen.

(4) **Security Deposit** — A security deposit is usually in an amount equal to one or two months’ rent. Although the landlord will receive some minimal level of return, it is not the best solution to a situation where a tenant is or will be in excessive arrears. For a further discussion on this and other related issues see the chapter entitled: “Guarantees, Indemnities, Letters of Credit, Security Deposit and Landlord Security”.

(5) **Oppression Remedy** — Consider the advisability of attempting to pierce the corporate veil and seek an oppression remedy against the directors of a defaulting corporate tenant.\(^\text{89}\) For example, in *Novacrete Construction Ltd. v. Profile Building Supplies Inc.*,\(^\text{90}\) the

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court was asked to consider a number of different issues including whether the actions of the tenant’s principal entitled the landlord to an oppression remedy under s. 247 of the Business Corporations Act (“OBCA”).\(^\text{91}\) The oppression remedy issue was in connection with the tenant’s principal having transferred the tenant’s assets to a new corporation with the alleged intention of defeating the landlord’s claim for rent. The court held that s. 247 of the OBCA should be interpreted as a broad remedy that was available to the landlord under the circumstances. Specifically, the court found that the tenant’s principal had “exercised his powers in an unfair manner which disregarded the interests of the plaintiff” landlord.\(^\text{92}\) The asset transfer to the new corporation was oppressive and prejudicial in the court’s view and the landlord was entitled to recover compensation for damages as against the principal, the new corporation, and the tenant who were all jointly and severally liable to the landlord. For a further discussion on this and other related issues see the chapter in this book entitled: “Piercing the Corporate Veil” by Jeffrey Lem.

**OPTIONS AVAILABLE TO TENANTS ON LANDLORD’S BREACH OF COVENANTS**

**Set-Off**

Most leases provide that rent is paid without set-off, abatement or deduction of any kind. Landlords insert this provision in leases because the provisions of s. 35(1) of the CTA provide that “A tenant may set off against the rent due a debt due to the tenant by the landlord”. Leases do not usually contain a right on the part of the tenant to set-off against rent, except in cases relating to damage and destruction in circumstances in which the premises cannot be used by the tenant for their intended purpose.

Recently, strong tenants have been more successful than in the past in negotiating set-off rights if the landlord breaches its obligations under a lease. While the landlord will take the position that rent must be paid, and in fact the landlord may be constrained by the provisions of its mortgage which likely do not permit set-off rights on the part of tenants, many tenants are of the view that if the landlord does not perform its obligations, the tenant should be entitled to exercise a right of set-off.\(^\text{93}\) More
particularly, tenants will often negotiate for a provision which would provide that if the landlord is in breach of its covenants (for example a covenant to repair or to provide utilities or other services) the tenant, after notice to the landlord, would be entitled to perform the covenant itself, thereafter setting off the cost of doing so against the rent otherwise due. Landlords strenuously object to provisions such as these but, if there is no choice but to agree, the landlord will at least require that it be given substantial notice before the tenant performs the covenant on behalf of the landlord, and that if the landlord disputes that it is in breach, the matter be referred to arbitration rather than the tenant being entitled to arbitrarily perform the covenant and set-off against rent. As well, before the tenant is entitled to set-off, the effect of the breach on the part of the landlord should materially adversely affect the tenant’s ability to carry on its business in the premises. The landlord might also negotiate a limited set-off against basic rent only, and perhaps against no more than one-half of the basic rent payable in any month.

**Damages**

Traditionally, the tenant’s principal remedy for breaches by the landlord of its obligations under the lease is damages. Unfortunately, if the tenant is materially adversely affected by the landlord’s breaches, initiating a claim for damages, which can be a lengthy and costly process, is not very satisfying or practical.

**Specific Performance**

Specific performance is an equitable remedy which courts are reluctant to order unless a court determines that it would not be appropriate, or just, in the circumstances for the tenant’s remedies to be restricted to damages. As discussed above, courts generally are reluctant to order specific performance because enforcement would, in most cases, require supervision by the courts. Specific performance may be an appropriate remedy for breach of the covenant to renew\(^\text{94}\) and for breach of a covenant to repair where the work can be specified with sufficient particularity.\(^\text{95}\)

**Injunction**

Generally speaking, the court will consider the balance of convenience and the inadequacy of damages to each party in determining whether to grant an injunction.\(^\text{96}\) Examples of when an injunction might be appropriate include situations in which the tenant is attempting to restrain


\(^{96}\) See *American Cyanamid Co. v. Ethicon Ltd.*, \([1975]\) A.C. 396 (H.L.).
the landlord from breaching a restrictive covenant prohibiting the leasing of space to a competitive business\footnote{Country Stop Donuts Ltd. v. Great West Life Assurance (1996), 5 R.P.R. (3d) 187, [1996] O.J. No. 3521 (QL) (Ont. Ct. (Gen. Div.)).} (in an office lease, most likely only relevant if a major tenant, such as a bank head office, has restrictions in its lease), or in which a tenant is seeking a court determination of the rights of the parties and wishes to restrain the landlord from evicting the tenant until those rights are determined.\footnote{Mah v. Truscan Realty Ltd. (1996), 42 Alta. L.R. (3d) 182, 3 R.P.R. (3d) 187 (Alta. Q.B.) (1989), 59 D.L.R. (4th) 1, [1989] 5 W.W.R. 481 (B.C.C.A.).}

**Fundamental Breach**

Termination of the lease by the tenant may be justified under the contract law principle of fundamental breach. Contract law recognizes when a party to a contract commits a breach so significant that it deprives the other party of the very essence of that for which it contracted, the other party is entitled to treat the contract as at an end and sue for damages. Such a breach is said to go to the “root of the contract”. If the court finds that there has been a fundamental breach by the landlord, the tenant may then walk away from the lease and, additionally, claim against the defaulting landlord for damages suffered as a result. For example, in \textit{Lehndorff Canadian Pension Properties Ltd. v. Davis Management Ltd.},\footnote{(1989), 59 D.L.R. (4th) 1, [1989] 5 W.W.R. 481 (B.C.C.A.).} the court held that the landlord had effectively deprived the tenant of the economic benefit and enjoyment of the balance of its lease term in unreasonably withholding its consent to an assignment of the lease by the tenant, and thus, committed a breach of a fundamental term of the lease amounting to anticipatory repudiation on the part of the landlord which, when accepted by the tenant, terminated the lease without further liability. In \textit{Ad Hoc Management Inc. v. Prudential Assurance Co.},\footnote{[1995] O.J. No. 1419 (QL), 55 A.C.W.S. (3d) 409 (Ont. C.A.); see also Chisos Investment Co. v. Houlahan, [1999] O.J. No. 1374 (QL), 87 A.C.W.S. (3d) 805 (Ont. Ct. (Gen. Div.)). (2000)], 31 R.P.R. (3d) 179, 2000 BCSC 574, affd 216 D.L.R. (4th) 392, [2002] 9 W.W.R. 193 (B.C.C.A.).} the lease contained a right of first refusal in respect of adjoining space for the purposes of expansion by the tenant, but the landlord leased the adjoining space to a third party without notice to the tenant. Although the Ontario Court of Appeal acknowledged that the landlord’s mistake was innocent, and that the tenant would obtain a significant financial advantage by extracting itself from its lease, the court held that the tenant’s ability to expand was fundamental to its bargain and declared that the lease had been terminated.

Cases involving significant leaks in leased premises have had mixed results. In \textit{Shun Cheong Holdings B.C. Ltd. v. Gold Ocean City Supermarket Ltd.},\footnote{(2000), 31 R.P.R. (3d) 179, 2000 BCSC 574, affd 216 D.L.R. (4th) 392, [2002] 9 W.W.R. 193 (B.C.C.A.).} the court concluded that the landlord’s failure to rectify the leakage problem was a fundamental breach and the tenant was justified in
terminating its lease. In contrast, in *Framlance Properties Ltd. v. Dahan’s Fashion Optical Ltd.*, although the court acknowledged that the roof leakage caused the tenant significant difficulty, it held that there was no evidence showing that such leakage rendered the premises uninhabitable and thus there was no fundamental breach of contract.

**CONCLUSION**

When negotiating a lease, both the landlord and tenant should give consideration to the default provisions in the lease, and the rights and remedies available to them (pursuant to the lease and law) in the event of a default. While one always hopes that it will not be necessary to resort to those rights and remedies, neither party will want to be unduly constrained should it be necessary to do so. If a default does occur, both parties should carefully consider the options available to them before taking steps to enforce their rights.

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**Appendix**

![Diagram of Breach and Remedies]

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