LANDLORD AS CREDITOR:
What Remedies are Available?

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Introduction

In this brief paper, we have been asked to provide an overview of the traditional rights and remedies available to a commercial landlord when faced with indebtedness owing by a tenant. This topic is extremely broad and can cover a wide variety of issues. However, the analysis in this paper will be limited to a discussion of:

- the relevant considerations to be taken into account by a landlord in weighing its options upon a tenant's default;
- the types of default; and
- the landlord's traditional remedies;

Relevant Considerations

At the risk of stating the obvious, the primary sources of a landlord's right to invoke enforcement remedies and the rules and regulations governing the process of enforcement are set out in either of the *Commercial Tenancies Act* ("**Act**"), the *Short Form Of Leases Act* ("**Short Forms**") (the Act and Short Forms are sometimes collectively referred to herein as "**Legislation**"), and the lease agreement.

Most of the enforcement provisions and remedies available to the landlord are set out in the typical commercial lease agreement. By way of an example, the "default and remedy" provisions in the standard commercial lease attempt to articulate a number of remedies to which the landlord is entitled at law, and supplement these remedies by reducing or eliminating notice periods provided by statute, as well as providing for further remedies. Indeed, under subsection 18(1) of the Act, a landlord may not terminate a lease for non payment of rent until the rent is in arrears for fifteen (15) days or more. Typically, landlords are not prepared to wait for fifteen (15) days to terminate the lease of a troublesome tenant and, therefore, the time period is often abridged by contract.

In the main, the remedies stipulated in the lease agreement will govern; however, there are situations where the Legislation will trump the provisions of the lease, so an advisor to a commercial landlord must exercise caution and always keep the Legislation in mind.

Prior to embarking on the course dictated by the exercise of any given remedy or remedies, the landlord and its advisor should consider the potential risks and benefits from a practical point of view. For example, if the defaulting tenant occupies premises in a project with a number of other vacancies, the landlord may prefer not to exercise a legal right which will lead to yet another vacancy, unless the landlord has a tenant waiting in the wings to occupy the premises.

Types of Default

(a) Monetary Default

The most obvious type of default under a lease is the failure of a tenant to pay rent when the same falls due.

Beyond basic rent, in retail leases, tenants are often required to pay a percentage rent based on a percentage of the sales from the leased premises. Additionally, commercial leases generally provide for a number of other items that a tenant is required to pay to a landlord as "additional rent", including, but not limited to:

(a) a proportionate share of the landlord's costs of operating the project in which the leased premises are located (for example, capital tax, large corporations' tax, management and administration fees, etc.);
(b) a share of realty taxes payable in respect of the project; and

(c) a share of utility charges incurred in respect of the project.

The landlord's remedies for default in the payment of rent are better than remedies for default in payment of other amounts. For example:

(a) distress is a remedy available only for non-payment of rent;

(b) termination of the lease can generally be more easily achieved for non-payment of rent than other monetary defaults; for one reason there are invariably less onerous notice requirements in leases and under statutes for non-payment of rent than non-payment of other amounts (compare for example subsections 18(1) and 19(2) respectively of the Act); and

(c) on bankruptcy of a tenant, a landlord has the right to accelerate "rent" and has a preferred claim for "accelerated rents".

To optimize the landlord's remedies on default in payment of amounts which would not otherwise be "rent", it is common practice for the lease to contain a contractual provision to the effect that all amounts payable by the tenant under the lease, whether to the landlord or otherwise, are deemed to be "rent". Leases generally refer to such amounts collectively as "additional rent".

(b) Non-Monetary Default

All other breaches of obligations that do not directly require the payment of money represent events of non-monetary default. Typical examples of non-monetary defaults include the breach by a tenant of its obligation to maintain the premises in "first-class condition" or to make certain specified repairs.

Given the focus of today's programme, this paper shall focus on monetary defaults and the remedies available to a landlord upon the occurrence of same.

Remedies

(a) Generally

As was originally articulated in the leading case of *Highway Properties v. Kelly Douglas*, [1971] S.C.R. 562, a landlord has four (4) exclusive options upon a tenant's default:

1. do nothing to alter or terminate the lease but insist on performance of the lease and sue for rent or damages on the basis that the lease remains in force ;

2. terminate the lease and sue for rent or damages outstanding or damages incurred to the date of termination; and

3. on proper notice to the tenant, re-enter to re-let the premises on the tenant's account;

4. on proper notice to the tenant, terminate the lease and claim damages for the breach of the lease, including for future losses;

Any time a landlord makes the decision to forfeit the lease and/or re-enter the leased premises, it should ensure that any notice required pursuant to the lease or the Act is validly prepared and served and that the relevant time period has passed. Particular attention should be paid to subsections 18(1) "Re-entry on Non-payment of Rent" and subsection 19(2) - Re-entry on account of Other Defaults.

A landlord must consider with care the question of whether or not to terminate the lease and sue for future damages or not to terminate the lease and insist on the tenant's performance of its obligations. The landlord must also make it clear by its conduct as to which one of its remedies it is pursuing because there may be different ramifications of each, such as the duty to mitigate upon termination.

(b) Termination by Landlord

As mentioned earlier, the *Highway Properties* case made it clear that a landlord who exercises the right to terminate its lease can, on proper notice, sue for damages for the loss of future rent for the unexpired term of the lease (less the actual rental value of the premises over the term) as this claim amounts to a claim for breach

of contract. As such, the landlord also takes on the corresponding duty to mitigate its damages. It is important to reiterate that the landlord is under no such duty if it decides to preserve the lease and sue for rental arrears only. In addition to present value of expected future rent, damages may also be claimed for other losses, including costs of re-renting the premises, damages for unauthorized renovations, and interest in accordance with the *Courts of Justice Act*.

A landlord desirous of terminating the lease must be careful that it does not engage in conduct that may be construed as waiving its right to terminate the lease based on the tenant's default. The case law is clear that if a landlord accepts rent after the occurrence of a breach by a tenant which would otherwise have entitled the landlord to terminate the lease, the landlord is taken to have waived its right to terminate based on that particular default, even if the landlord had no intention to waive the breach. In order to avoid this result, a prudent landlord's counsel should ensure that a "non-waiver" provision is included in the lease that is drawn with the utmost care and specificity because the Courts have demonstrated a propensity to apply the waiver principle if there is any ambiguity in the "non-waiver" provision.

Further, relying on principles of equitable estoppel can prevent landlords from strictly enforcing lease provisions should they knowingly "turn a blind eye" to a tenant's breach of its obligations or restrictions under a commercial lease. Equitable estoppel, which is sometimes also referred to as proprietary estoppel in real estate cases, will prevent a person from insisting on his or her strict legal rights, whether arising under a contract or on title deeds, or by statute, when it would not be equitable for him or her to do so, having regard to the dealings that have taken place between the parties. Therefore, prudent landlords should not tolerate any breach by a tenant, no matter how minor or trivial it might appear at the time, otherwise they may be estopped from requiring strict compliance by a tenant with the provisions of the lease. For example, in the case of *Aguacil v. 520301 Ontario Inc.*, [2003] O.J. No. 328 (S.C.J.), the lease permitted the tenant to use the premises for a vintage furniture reconditioning and graphic design establishment for a term of three (3) years. Toward the end of the term the tenant indicated to the landlord that it wanted to renovate the premises and use the space as a film, television and photographic production site. Following these discussions, the party signed a letter of agreement that extended the term of the lease, set out the rent payable during the renewal term, and permitted certain renovations by the tenant; however, the letter did not mention any change in the use of the premises. Several months later, after observing a wedding reception at the premises, the landlord served the tenant with a notice of breach of the use covenant contained in the original lease. The Court applied the doctrine of proprietary estoppel to prevent the landlord from enforcing the use clause in the lease because it would have been inequitable for him to do so having regard to the fact that the landlord was aware of the changes to the premises and had not attempted to stop the tenant or otherwise strictly enforce his rights under the lease.

In order to facilitate the landlord's forfeiture, most commercial leases contain a provision that entitles a landlord to re-enter the premises following a breach of the tenant's obligation to pay rent. Where such a provision is absent, the landlord's forfeiture rights for non-payment of rent are set out in subsection 18(1) of the Act, and for non-monetary breaches in subsection 19(2). It should be noted that subsection 18(1) specifically allows the parties to contract out of this subsection. Subsection 19(2) does not specifically allow the parties to contract out of the subsection, and while there is case law that suggests that it is possible for parties to contract out of this section, the better view, based on the numerous cases dealing with relief from forfeiture, is that the parties cannot contract out of subsection 19(2).

In any event, it is important that the landlord follow the notice requirements in the lease or the Act, as applicable. Otherwise, the forfeiture will be unlawful.

Written notice is not in and of itself adequate to terminate the lease, as the landlord is also required to exercise its right of forfeiture or re-entry to the premises. In order to exercise its right of re-entry, the landlord must:

(a) physically re-take possession of the premises – where landlord is entitled to use force to effect a physical re-entry onto the premises; however, in most cases the landlord utilizes the services of an experienced bailiff in order to assist with the re-entry;

(b) make an application for summary proceedings under Part III of the Act to terminate the lease;

(c) commence an action for a declaration that the lease has been terminated and an order for possession of the premises in favour of the landlord. This is the remedy of choice where the landlord is desirous of a speedy result or where the landlord wishes to add other claims which are not capable of being dealt with under Part III of the Act, for example, a claim for damages for rental arrears; and

(d) enter into a written agreement with the tenant that terminates the lease.**[1]**

Generally speaking, forfeiture is not looked upon favourably by the Courts except in cases of repeated non-payment or dilatory payment of rent, as it is often considered to be excessive and unjustified and therefore tenants can often avail themselves a relief under subsection 20(1) of the Act wherever they can establish the landlord failed to engage in the correct procedure to effect the forfeiture of the lease or where having regard to the conduct of the parties, the Court thinks fit. In particular, with respect to forfeiture on account of a breach of a non-monetary covenant, there are 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 subsection 19(2).

(c) Re-Entry Without Termination

In the standard commercial lease you will invariably find a provision that enables a landlord to re-enter the leased premises without terminating the lease and to re-let the premises on the tenant's account. Prior to the *Highway Properties* case, this procedure was required to enable a landlord to obtain damages for the loss of future rents; however, the *Highway Properties* case confirmed that the landlord has the right to both terminate the lease and claim for the loss of future rents, provided that it proceeds correctly and gives notice of its intent to claim damages in advance.

If the landlord re-enters a premises without terminating for the purpose of re-letting on the tenant's account, the landlord must be careful to avoid a finding that it has entered into a new arrangement with a new lessee that goes beyond the rights that were previously accorded to the defaulting tenant. The result would be that, at the time of re-letting, the landlord may be deemed to have terminated the lease, and therefore may be disentitled to a claim for future damages.

Examples of provisions that may be construed as creating a "new arrangement" with a new lessee include the granting to the new lessee of an option to purchase, or of a term which extends beyond the term of the defaulting tenant's lease. A further issue is that if the landlord does not wish to terminate the lease, it must be careful not to take any steps which might be interpreted as termination, such as, re-entering the premises for any purpose, without making it clear by written notice to the tenant that it is re-entering to re-let on the tenant's account without terminating. In order to effect the right of possession-without termination, a landlord must ensure that its position is clear in notices given to the tenant both in advance of and at the time of entering the premises, because a landlord by its conduct may affect the termination of a lease without any intention to do so.

In some cases, the very act of seeking to re-rent the premises, even without re-entering, might be taken as termination or acceptance or surrender and, accordingly, the landlord should give written notice to the defaulting tenant as to which option it is pursuing and reserving its rights. If the nature of the tenant's default is non-monetary, then ordinarily a landlord can rely upon a provision found in most standard commercial leases which provides that if the tenant commits a breach of a non-monetary obligation, the landlord has the right, on notice to the tenant, to remedy the breach at the tenant's cost payable to the landlord on demand. The practical result of this remedy would be to convert a non-monetary default into a monetary default.

The primary benefit to a landlord of not terminating a lease is that preservation allows the landlord to sue the tenant for rental arrears and avoid the duty to mitigate its losses.

(d) Distress

Distress is a combination of a statutory (the Act) and common law self-help remedy entitling the landlord, prior to the termination of the lease, to seize, take possession of, and sell the goods and chattels (not fixtures) of the tenant located at the premises to satisfy arrears of rent.

At first blush, distress sounds like an ideal remedy. However, there are a number of restrictions on this remedy set forth in both the Act and at common law, which a landlord must carefully follow, including:

(a) while there is no requirement to give prior notice of the distress under the Legislation, proper notice must be given to the tenant at the time the distress is taken (sections 34(i) and 36 of the Act);

(b) after giving notice of distress and taking possession of the chattels, but prior to marketing the chattels for sale, the landlord must wait five (5) days and then must have the distrained goods appraised by two (2) independent appraisers;

(c) when selling the distrained goods, the landlord must obtain "the best price available in the marketplace for them"; there is no specific requirement with respect to the process that must be following for the sale of the goods; however, the landlord can be exposed to liability for making an "improvident" sale;

(d) the landlord must be careful not to seize and sell an amount of the tenant's property that greatly exceeds the quantum of the tenant's arrears then in question. This is an onerous and ambiguous restriction because it is clear that in order for the landlord to recover the full amount of rent in arrears and the cost of exercising its right of distress and marketing and selling the tenant's chattels, the distress will almost certainly have to provide a cushion and this should not subject the landlord to damages; however, if the distress is "excessive" (ie. the value of the distrained goods is unreasonably in excess of the amount in arrears) the landlord is exposed to the risk of liability damages. The question then becomes what is excessive in the circumstances;

(e) distress must be levied during daylight hours, that is, after dawn and before sunset; and

(f) chattels exempt from execution under the provisions of the *Execution Act* (Ontario) may not be distrained.

The right of distress is a unique right available to a landlord. In order for the landlord to lawfully exercise the right of distress, it is necessary that the landlord-tenant relationship remain intact until the completion of the distress. Accordingly, the tenant must be in possession of the premises and there must be arrears of rent due and payable to the landlord prior to the sale of the chattels and the application of the sale proceeds on account of the arrears of rent.

Although landlords and bailiffs have now become more sensitive to this point, it formerly was common practice for a landlord to purport to distrain by changing the locks on the premises. Case law has made it clear that the changing of the locks by the landlord is, in effect, a re-entry into the premises and termination of the lease, even if such action is purportedly for the purpose of securing the chattels on the premises. Once the lease is terminated the landlord loses its rights to distress and the tenant has the right to remove the chattels.

The other issue for a landlord exercising its right of distress is to determine who owns the chattels located on the premises. Under subsection 31(2) of the Act, the landlord may not distrain on the chattels of any person except the tenant or other "person who is liable for the rent". The landlord is not entitled to chattels on the premises that were provided to the tenant on consignment or under a true lease.

Generally Speaking:

(i) except for chattels on the premises which are subject to a true lease (a lease which is not in the nature of a financing arrangement), the race is to the swiftest; in other words, priority goes to the party who first seizes the chattels; however, it must be noted that the Ontario Court of Appeal has held that a landlord's distress completed within three (3) months of a tenant's bankruptcy, amounts to a "fraudulent preference", and that the proceeds of the distress belong to the trustee in bankruptcy, leaving the landlord with merely a preferred claim under the *Bankruptcy and Insolvency Act (Canada)*. This finding can potentially require a landlord that otherwise successfully completed a distress to repay the proceeds therefrom to the trustee of the bankrupt, which severely limits the efficacy of this remedy. If a tenant becomes bankrupt before the landlord completes its distraint or within three (3) months of the landlord's completion of the distraint, the landlord's claim for distress will be defeated in the chattels or proceeds from the sales of the chattels, which chattels vest in the trustee. This results in wasted time, effort and expense on the landlord's part.

(ii) with respect to chattels leased pursuant to a true lease, title to the chattels is in the lessor and the landlord cannot gain priority by seizing the chattels.

Often in attempting to exercise its right of distress the landlord or its bailiff will encounter a difficult tenant that fervently objects to the act of distress. Such an uncooperative tenant may present the possibility for a physical confrontation and/or attempt to remove the goods from the premises (as right of distraint can only be exercised on the premises subject to the lease save right to trace chattels of tenant for 30 days under section 48 of the Act).

Needless to say, in such circumstances, the landlord must avoid physical confrontation in order to avoid exposure to liability for trespass and assault. The landlord also has to be aware of its right to hold the tenant and any other person who assists the tenant in fraudulently removing goods from the premises to avoid distress personally liable under section 50 of the Act.

Notwithstanding the foregoing, if the tenant and its principals are experiencing financial difficulty it may well be able to successfully remove goods from the premises to avoid the distress without consequence.

Practically speaking, the “race to the swiftest” and corresponding incentive for the landlord on the one hand and the secured creditor’s on the other hand to seize the tenant’s assets as soon as possible can have a counter-productive affect on each of the landlord, the tenant and the secured creditor, because it may result in the failure of the tenant’s business that otherwise may have been in a position to work its way out of its financial difficulties through a proposal under the *Bankruptcy and Insolvency Act (Canada)*, plan of arrangement under the *Companies’ Creditors Arrangement Act*, or some other “turnaround” measure.

It should be noted that the landlord cannot sue for rent until the distress has been completed (i.e. the goods have been appraised and sold). It should also be noted that if a deficiency remains after the goods subject to the distress have been sold, the landlord may sue for the deficiency, or terminate the lease for arrears of rent as a result of the fact that a deficiency remains.

(e) Other Remedies

(i) Legal Action for Collection of Rental Arrears

Upon default, the landlord is entitled to sue for rent in arrears or damages on the basis that the lease remains in force. This scenario is often utilized where the landlord has a mortgage in which it has covenanted not to terminate the lease(s) without the mortgagee’s consent. Under the *Rules of Civil Procedure (Ontario)* the claim may be for arrears of rent at the date of issuing the Statement of Claim, and for rent accruing due in the future, up to the date of trial. The clear advantage to pursuing a suit in this manner is that the landlord is able to both preserve the lease of the premises while avoiding the duty to mitigate its losses (which it is required to do if it terminates the lease).

(ii) Injunctive Relief

Perhaps the most effective remedy in a case where a landlord is desirous of preventing the committing of or continuance of a breach of a non-monetary obligation under the lease. For example, a breach by a tenant of a restrictive covenant, an attempt by a tenant to vacate the premises or remove the chattels from the premises contrary to the provisions of the lease.

Generally speaking, an interlocutory injunction will be granted where it appears to be just or convenient for the Court to make such an Order in the circumstances. This is a highly discretionary remedy and hence very unpredictable. The test for the granting of an injunction is set out in the 1994 Supreme Court of Canada decision in *RJR MacDonald v. Canada (Attorney General)* [1994] 1 S.C.R. 311 as follows:

> (a) the plaintiff or moving party must be able to establish that there is a serious issue to be tried in the case;
>
> (b) the plaintiff or moving party must establish that a refusal of the interlocutory injunction will result in irreparable harm to the Plaintiff which cannot be adequately compensated in damages; and
>
> (c) the plaintiff or moving party must be able to prove that the balance of convenience as between the plaintiff and defendant in the case lies with the plaintiff, such that inconvenience and harm to the plaintiff should the court refuse to grant the interlocutory relief sought would outweigh the benefit to the defendant.

It is very difficult to convince a Court to grant interlocutory injunctive relief for the enforcement of conditions in a lease that require action on the part of the tenant. This is due to the fact that the Courts are loath to grant interlocutory injunctions where it is conceivable that the performance of the mandated action will require further supervision of the Courts.

A second type of injunction is a permanent injunction which is granted after the rights of the parties have been finally determined by the Court. Courts are more inclined to grant permanent injunctions where the plaintiff is able to establish that its rights have been infringed in the past and it is quite likely that its rights will be infringed in the future.

Some Final Thoughts

In this brief paper, we have only been able to address in a very embryonic fashion the rights and remedies available to commercial landlords who must deal with a defaulting tenant.

It should be noted that there are various, and oftentimes effective, proactive protective measures a landlord can undertake at the inception of a lease arrangement which will serve to minimize loss and aggravation in the event of a default. Such measures include the taking of security and the obtaining of third party assurances (i.e.: letters of credit, guarantees, indemnities, etc.). Unfortunately, time and space constraints do not permit a discussion of these measures here.

For your ease of reference, we attach as Schedule "A" (PDF) to this paper, a rather simple but effective decision tree which summarizes the rights and remedies available to a landlord on the occurrence of an event of default by a tenant. ***If you are a landlord, may you never have cause to refer to it!***

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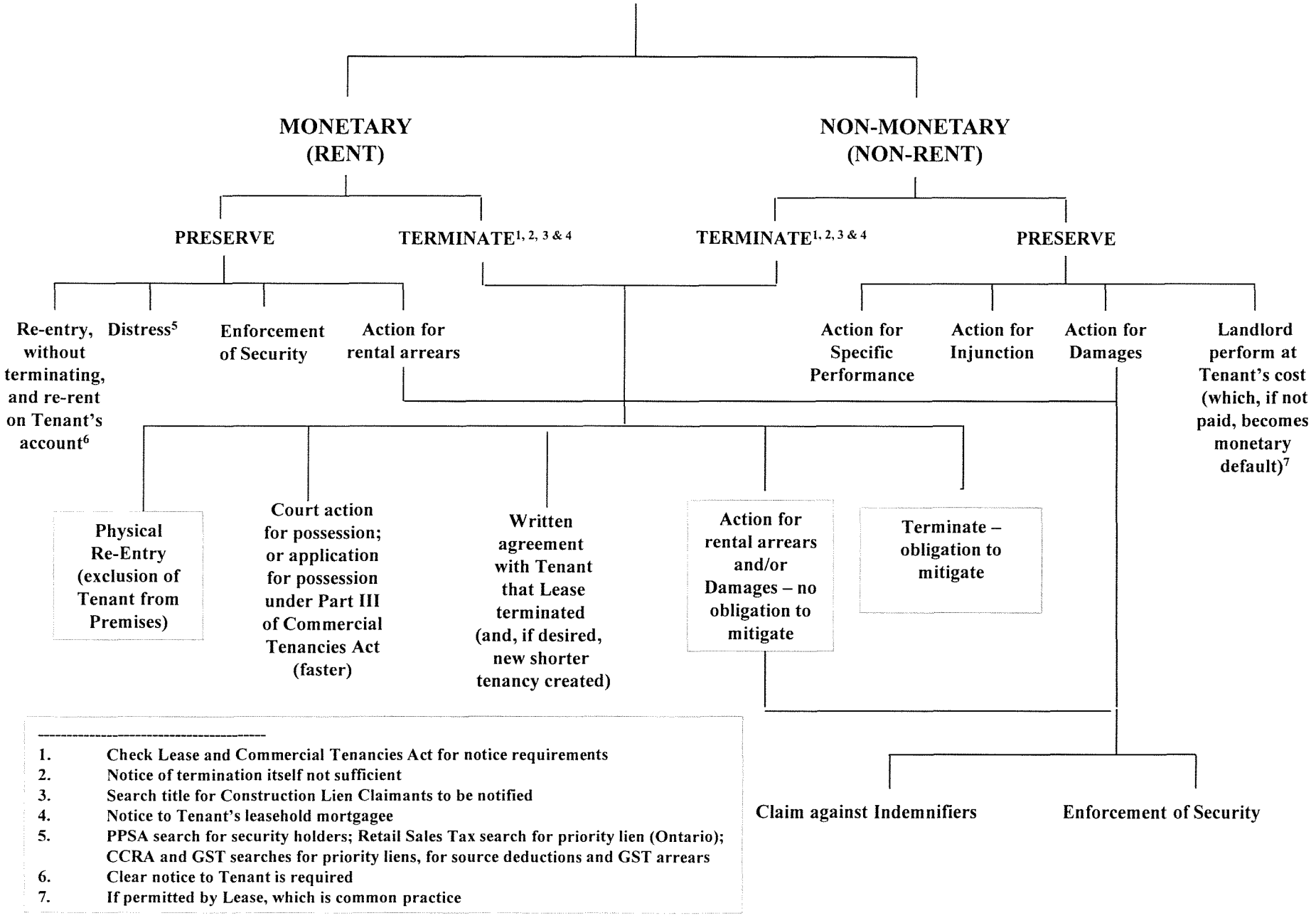
[1] While the possibility of entering into an agreement with the tenant to terminate the lease is very remote, if a tenant is in default and faced with the choice of being physically removed from the premises on the one hand, or perhaps being afforded an opportunity to remain the premises as a monthly tenant or a tenant at will, the tenant might be willing to enter an agreement to terminate the lease. It should be noted that this type of agreement, which is in effect a surrender of the lease, may be voidable as a fraudulent preference.

SCHEDULE "A"

ONTARIO
TENANT'S BREACH OF LEASE
DECISION TREE



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1. Check Lease and Commercial Tenancies Act for notice requirements
2. Notice of termination itself not sufficient
3. Search title for Construction Lien Claimants to be notified
4. Notice to Tenant's leasehold mortgagee
5. PPSA search for security holders; Retail Sales Tax search for priority lien (Ontario); CCRA and GST searches for priority liens, for source deductions and GST arrears
6. Clear notice to Tenant is required
7. If permitted by Lease, which is common practice