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PROPERTY

- Leasing Update

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Myopic Stubbornness and Other Hazards: *A few of the interesting cases of 2011*

By Angela Mockford

The Courts (and litigators) just can't seem to get enough of fascinating legal expressions, such as "piercing the corporate veil", "spent breach", and "estoppel". In leasing litigation in particular, these notions have experienced a bit of a revival. But nothing seems to grab attention, and drive people to Court, like a good old-fashioned "net lease" clause. Read on for our selection of some of the more intriguing and entertaining cases of the year.

Piercing the Corporate Veil

Flying Saucer Restaurant Ltd v Lick's Leasing et al (Ontario Superior Court)

This case is a personal favourite (perhaps because it takes place in my home of Niagara). The Landlord leased the premises to the corporate defendant, which sublet to another company, which then abandoned the premises. Finding that its tenant had no assets, the Landlord, "a wily businessman" in what the Court termed a "Hail Mary effort", sued "a cluster of companies owned by a wilier businesswoman, in a desperate attempt to find a pocket with money", along with the businesswoman personally on the basis of an alleged personal guarantee. The claim against the owner of the company was dismissed on the basis that there is nothing improper about incorporating a company solely for the purpose of entering into a commercial lease – the incorporation in itself did not constitute fraudulent or improper conduct that would justify piercing the corporate veil and holding the owner personally liable. In the absence of credible evidence of misrepresentation and credible evidence of personal guarantees, the Court had no basis upon which to grant the Landlord what it sought. At the end of the decision, the Court expressed what may be the best sound bite in leasing law this year:

> *"I am surprised that he thought he could prevail in this action. Myopic stubbornness is an expensive trait when it comes to litigation."*

Spent Breach

1290079 Ontario Inc v Beltsos (Ontario Court of Appeal)

The Tenant leased an old service station from the Landlord for 11 years, with an option to renew for an additional five, provided the Tenant did not default. The Tenant was responsible for insuring the property. The Tenant subsequently subleased the property. The subtenant's insurance policy was found

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to be defective. On September 15, 2007, the day before the insurance policy was made good (of course), a third party sustained an injury on the property. On May 15, 2009, the third party filed a claim against the Tenant, the Landlord, and the subtenant. In June 2009, the Tenant tried to renew the head lease by letter. The third party's action was an ongoing issue. The application judge found that the Tenant's 2007 breach of the insurance terms of the lease subsisted until the renewal dates in 2009 and 2010, and that the breach disentitled the Tenant to renew the lease. Essentially, it rejected the argument of "spent breach" – that an historical breach, once remedied, will not preclude a Tenant from exercising an option to renew so long as the lease is "effectively clear" on the renewal date; in this case, the lease was not effectively clear because the Landlord had a subsisting cause of action against the Tenant that was rooted in the breach. As the Landlord faced expense and uncertainty that would have been avoided if the Tenant had not been in breach, the breach subsisted and the Tenant forfeited its right to renew. This decision lends a whole new meaning to the expression "bad timing"!

From Offer to Lease

Hashem v 2069513 Ontario Ltd (Ontario Divisional Court)

In this decision (argued successfully at first instance and on appeal by our own Krista Chaytor), the Court upheld the finding of the lower court that the agreement to lease was binding. The Tenant argued that the inclusion by the Landlord in the formal lease of expanded wording amounted to material departure from the agreement to lease; instead, the Court noted that it was the Tenant who had asked for entirely new provisions to be incorporated. In order for a court to find an agreement to lease to be enforceable the agreement must meet the criteria listed in *Canada Square Corp v VS Services Ltd* by listing the parties, a description of the premises to be demised, the commencement of the term, the duration of the term, the rent and all material terms of the contract not being matters incident to the relation of Landlord and Tenant, including any covenants or conditions, exceptions or reservations. The document satisfied those requirements. Furthermore, an agreement to lease requiring a later standard form lease is still enforceable. It does not affect the binding nature of the agreement to lease, even where the Tenant is authorized to make reasonable amendments to the standard form lease. In order for inconsistency to be the basis of invalidity, the Tenant must establish that the terms of the standard form lease are so inconsistent with the terms of the agreement to lease that they evidenced an intention of the Landlord to repudiate the agreement. Landlords in Ontario are dusting off their "lease execution" clauses as we speak …

The "Net Lease" Clause Revisited

The greatest number of interesting cases in 2011 by far deal with the "net lease" clause. The "net lease' clause is designed to permit a landlord to sit back, collect rent, and bear no expense in respect of a property (other than one expressly mentioned) – and therefore, to charge all costs in connection with the property to the tenants of that property. But the case law confirms that the clause, in the context of the whole lease, does not always operate that way …

Administration Fees

C.C. Tatham & Associates Ltd v 2057870 Ontario Inc (Ontario Superior Court)

The parties entered into a 10-year lease in which the Tenant was to pay a specified base rent along with "the moneys and other charges, costs and expenses herein provided to be paid by the Tenant". The lease also specified an administrative charge of 15 per cent for costs incurred by the Landlord if the Tenant failed to maintain. However, no other express administration or management fees were provided for in the lease, but the Landlord claimed they were payable on the basis that it was a "net lease". Referring to *Denninger Ltd v Metro International* ([1992] O.J. No. 838), the fees were disallowed. In *Denninger*, the Court had said:

> *… the collecting of rent, the banking of rent, the keeping of accounts in respect of rent paid and rent not paid … are all functions that would normally be done by a landlord … charges for the performance of landlord's duties should not be passed on to a tenant whether the words seeking to create a net lease are the words "absolutely net", "net net" or "net" or any other words of similar implication. If the landlord would have the tenant pay for some agent to perform the ordinary duties of a landlord, then it is the responsibility of the landlord to insert a term to that effect into the agreement to lease.*

In short, a "net" clause does not a "basket" clause make.

Exceptions to the "Net Lease" Clause

1645111 Ontario Limited v 1169136 Ontario Inc (Ontario Superior Court)

The lease was prepared on a Dye & Durham form and expressed to be "completely a carefree net lease for the Landlord". But it also said that "if the Tenant enjoys the use of any common areas and facilities not included in the Premises, the Tenant shall pay his proportionate share of the foregoing expenses relating to such common areas and facilities." The parties had inserted a new (non-Dye & Durham) Section 6(5), which said: "The Landlord shall be responsible for, at its expense, the maintenance of the structure of the buildings including, but not limited to, the roof, exterior walls and heating system". When the Landlord was compelled to replace the roof, at a cost of well over $50,000.00, it sought to recover a portion of the cost from the Tenant. Not surprisingly, the Court found that Section 6(5) was an "exception" to the net lease provision, and disallowed the Landlord's claim for roof costs. This case highlights one of the (other) hazards of using pre-printed forms: departing from the pre-printed text could lend even more weight than intended to the "extra" language!

Tenant's Duty of Due Diligence

Shunjing Trading Inc v E.B. Engineered Panels and Controls Inc (NB Court of Appeal)

The parties entered into a 2-year agreement to lease a unit in a new strip mall. The lease provided that all other charges and payments were "part of the additional rent and shall be the responsibility of the tenant." The Landlord was to undertake no work. The Tenant was to complete a bathroom and an office. The Tenant took possession, but learned later that the right of occupancy was subject to the installation of a $10,000 fire alarm and sprinkler system. The Landlord claimed the cost was the Tenant's, being "additional rent". The Tenant refused to sign the formal lease and left the premises after the Landlord refused to negotiate further. The Landlord sued. The trial judge concluded that the parties failed to agree on an essential term of the lease, and that the matter was not covered under the clause providing for "additional rent" as rental expenses are in the nature of recurring costs and not capital expenses, such as improvements to property. The Landlord appealed, but the appeal was dismissed. The Court of Appeal found that this was a case in which the premises were unfit for any purpose and could not be occupied legally until the safety standards had been met, and said (because the Landlord had been advised by its contractor three years prior of the sprinkler issue):

> *In law, there should be no reasonable expectation that the tenant's duty of due diligence embraced the obligation to determine whether the landlord or the landlord's contractor had complied with provincial or municipal legislation regulating the construction of buildings in regard to matters of general public safety. In circumstances where the landlord has full knowledge and responsibility for regulatory requirements pertaining to safety matters applicable to new constructions, the law should not obligate tenants to make the due diligence inquiries – or else to pay the installation costs for what amounts to a capital improvement – prior to entering into an agreement to lease.*

Landlords, still dusty from reviewing their "lease execution" clauses, are now dusting off their "as is" clauses …

Estoppel

OGT Holdings Ltd v Startek Canada Services Ltd (Ontario Superior Court)

The lease gave the Landlord the right to charge taxes on the basis of proportionate share or separate assessment. For years, the Landlord used the separate assessment method. It then decided to start charging using the proportionate share method of calculation, which resulted in a higher tax bill to the Tenant. The lease contained the usual "net lease" language. Again, the Court determined that the tax calculation language was an "exception" to the net lease regime. Even though the Tenant agreed with the calculations (taxes of over $300,000!), its position was that the Landlord had made an election to charge a certain way, upon which the Tenant had relied. The Court agreed that the Landlord was prevented from charging by the other method. It is interesting to note that the Tenant did not dispute that the Landlord may have had a right to re-elect, but argued that the Landlord *had not in fact re-elected*, and thus it remained "estopped" from claiming the difference in realty taxes for the relevant period. This case highlights the fact that despite the "black letter" of a contract, conduct of the parties over a period of time can result in new provisions being written in "invisible ink" (visible only to judges).

None of the results in the cases above would have been easy to predict; which makes it all the more poignant, because no doubt most of the parties involved in the disputes above were motivated by principle, or by the sheer amount of money involved, to take their cases all the way to hearing. Unfortunately for them, novel and passionate arguments do not necessarily result in success – but fortunately for us, they make for great reading!

Here's wishing you good sense – and good counsel – in 2012.

AUTHOR **Angela Mockford**

Angela is a commercial landlord or tenant's best asset. With over 13 years of experience in commercial leasing, she takes a modern, practical and cost-effective approach towards the negotiation of relationships between landlords and tenants. For Angela, it's all about getting the deal done on time and on budget – without sacrificing quality, the relationship, or the client's best interests. Her strengths include negotiating and drafting all manner of lease documentation, developing or improving standard forms for clients, and advising in cases of lease interpretation disputes – all with an eye on the bottom line.

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