

Estoppel Certificates: Avoiding Liability for Another Owner's Debts

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The court's recent decision in *Toronto Kosher Inc. v. Windward Drive Holdings Inc.* is a good reminder to landlords purchasing new properties of the importance of obtaining estoppel certificates. Estoppel certificates provide purchasers of property with information about the status of leases that is not necessarily available from a review of the document alone. Among other things, estoppel certificates usually require tenants to confirm that they have no right of set-off against the landlord/vendor. Without an estoppel certificate, a purchaser risks becoming liable for debts owing to a tenant by the vendor.

Toronto Kosher Inc. operates a butcher shop from leased premises in a building on Bathurst Street in Toronto. Deliveries are made to the back of the building which can be accessed by both a laneway running along the back of neighbouring properties owned by arm's-length parties and an adjacent vacant lot. When Toronto Kosher first leased its premises, the vacant lot was owned by a corporation related to the landlord. The lease required the landlord to enter into an agreement with its related company giving Toronto Kosher access over the vacant lot until Toronto Kosher was granted a registered legal right-of-way over the laneway. The lease also stipulated that the access agreement had to give Toronto Kosher an option to purchase the vacant lot for \$125,000 if its access was denied or extinguished unless the registered easement over the laneway was granted at which time the access agreement would be at an end. From the time the lease was signed in 2002, Toronto Kosher used the vacant lot (and not the laneway which was blocked with movable garbage bins) for access.

In April 2007, the landlord sold the vacant lot for \$438,000 without Toronto Kosher's knowledge. The sale did not interrupt Toronto Kosher's use of the vacant lot. In fact, Toronto Kosher did not discover the sale until a year later in April 2008. Toronto Kosher then commenced an action against the landlord for its breach of the option to purchase seeking damages for the difference between the sale price of \$438,000 and its option to purchase price of \$125,000. The landlord initially defended the action but (likely due to financial difficulties) stopped defending the action in September 2008.

In late 2008 or early 2009, Windward Drive Holdings Inc., the new landlord, purchased the building without obtaining an estoppel certificate from Toronto Kosher. In May 2009, about five months after Windward acquired the building, Toronto Kosher obtained a default judgment against the original landlord for over \$400,000. Toronto Kosher then took the position that it was entitled to set off the amount owing under the default judgment against rent owing to Windward.

The court considered the previous decision of *473807 Ontario Ltd. v. TDL Group Ltd.* In that case, the Ontario Court of Appeal held that a court-ordered set-off against rent owing to a previous landlord was enforceable against a mortgagee in possession. In reaching that decision the Court of Appeal interpreted a Postponement and Non-Disturbance Agreement between the tenant and the mortgagee as an agreement that if the mortgagee went into possession of the leased premises, it would take over the landlord's position and that the tenant would be in the same position in which it was when the landlord was the lessor. The Court of Appeal also considered the landlord's assignment of rents to the mortgagee and confirmed the rule that an assignee takes subject to all the equities.

In *Toronto Kosher*, the court agreed that Windward took an assignment of the lease subject to the equities and that equitable set-off was available to Toronto Kosher in principle. The court then looked at the test for equitable set-off and, in particular the requirement that the tenant's claim be so clearly connected with the demand of the landlord for rent that it would be manifestly unjust to allow the landlord to enforce payment. The court concluded that if the sale of the vacant lot had caused business damages to the tenant, then equitable set-off would have been available. In this case, however, the sale of the vacant lot had not interrupted Toronto Kosher's access to the leased premises and the court questioned whether Toronto Kosher's right to exercise the option had actually even been triggered. The court's concern was that the damages Toronto Kosher was looking to set off against rent did not arise from the loss of enjoyment of the leased premises. It concluded that in this case, it would be unjust to allow the tenant "through a happenstance of default judgment to recover what is in essence a windfall award for losses that were never sustained" and declined to permit the equitable set-off.

In the end, the specific facts of this case allowed the purchaser/landlord to escape liability for the prior landlord's actions. Despite the specific result, the *Toronto Kosher* case is nevertheless a good reminder that the principle that equitable set-off is available when the debt owing to a tenant by the previous landlord arises from the loss of enjoyment of the leased premises or is otherwise clearly connected with the demand for rent. Without an estoppel certificate, a purchaser risks taking on unexpected liabilities to existing tenants.

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