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BARRISTERS & SOLICITORS

"PITFALLS IN ENFORCING REMEDIES"

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PITFALLS IN ENFORCING REMEDIES

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PITFALLS IN ENFORCING REMEDIES

I INTRODUCTION

The title of this program is "Leasing Lawyers: Avoiding Hot Water in a Cold Economy". The economy is not as cold as originally thought it would be when this program was first developed. However, the pitfalls which await the unsuspecting lawyer, whether the economy is cold or hot, remain the same. This paper is not a comprehensive treatment of remedies in commercial leasing but rather an attempt to highlight and alert both landlord's and tenant's counsel to the issues and pitfalls they may encounter in the enforcement of commercial leasing remedies.

We will start by examining distress, which is a landlord's self-help remedy that flows from both common law and statute. It has developed over hundreds of years and is fraught with pitfalls for the unwary. As though this remedy was not involved enough, in early 1999 a whole new layer of complexity was added with the amendment of section 22 of the *Retail Sales Act*. Nevertheless, it is still a powerful and useful self-help remedy that landlords continue to use successfully.

Forfeiture, the next remedy we will examine, is another powerful self help remedy available to landlords and probably the most widely used. The courts have always stated that they look unfavourably on a forfeiture and are often very willing to grant relief from forfeiture. Some might say too willing, which leaves landlords wondering if they will ever be rid of certain tenants. If a landlord dots it "i"s and crosses its "t"s it can successfully terminate tenants subject always to the court's equitable jurisdiction to grant relief from forfeiture, which a court will rarely grant more than once to a defaulting tenant.

We will also consider the equitable principle of estoppel which frequently becomes an issue when enforcing commercial landlord and tenant remedies. This is understandable as the landlord and tenant relationship often lasts for years and much is said and done which may - but will not always

- alter the landlord tenant relationship. It is important that we learn how to recognize it and understand its implications.

The two main self help remedies of distress and forfeiture are landlord's remedies. On the other side of the ledger we have the tenant's favorite self help remedy - withholding rent. The question is often asked; when can a tenant withhold rent? As most leases contain a "no set off" provision one must look to the principle of equitable set off when deciding whether or not the tenant may withhold rent.

Finally, under the heading of "Piercing the Corporate Veil", we consider some strategies for dealing with tenants who have no assets or income. The flip side of this topic is; how we ensure that the corporate structures we put in place do in fact shield our clients from liability or how to make the tenant bullet proof?

Whatever the temperature of the economy, commercial landlords and tenants need to be aware of the pitfalls and peculiarities of remedies in commercial tenancies.

II DISTRESS AND ITS INHERENT RISKS[1]

1. What Is Distress?

The right to distrain flows from both common law and statute. The law of distress has evolved over many hundreds of years, and as a result is full of traps for the unwary. It is in reality a unique, and in many commentators view, a somewhat draconian remedy. Where rent is outstanding, it allows a landlord to seize and hold goods - chattels but not fixtures - of a tenant and sell those goods to pay the rent. This whole process takes place without any form of judicial supervision. Distress is a remedy that must be carefully considered and implemented with a great deal of caution if positive

[1] I would like to acknowledge the contribution of Eric Gillespie, now with the firm Markle, May, Phibbs for his invaluable contribution to the distress section of this paper.

results are to be achieved.

2. When Does The Right to Distrain Arise?

Distress is only available when there is a landlord and tenant relationship in place, and there has been a default in the payment of "rent". Distress is not available following termination of the lease.

The parties must look to the lease itself to determine what is defined as "rent". If there are arrears of rent then the landlord may distrain. If not, then the landlord has no right to seize the tenant's chattels. Where a tenant has abandoned its premises, the landlord may not have the right to distrain if the tenant is not actually in arrears. However, in such a situation the landlord should review its lease, as there may well be an act of default by the tenant - such as the failure to operate continuously - which is sufficient to trigger the accelerated rent provisions that are often found in leases. Accelerated rent once due and payable may be sufficient to found a right of distress.

3. Losing the Right to Distrain

In the same way that the landlord can lose its right to terminate the lease, the right to distrain can also be lost. For example, termination of the lease ends the landlord/tenant relationship and with it the right to distrain. As well, where a tenant has become bankrupt, statute law requires that even distraints that are already in progress must be halted, and the goods seized turned over to the bankrupt's trustee, unless the distraint is complete and the proceeds of the distraint have already been dispersed to the landlord[2].

Landlords can also waive their right to distrain by way of contract. This sometimes occurs with large lenders or other financial institutions, who will not grant loans to a tenant unless they obtain the landlord's agreement to forego its right to distrain. Consequently, the landlord must review all documentation associated with a particular tenant before deciding to distrain

[2] *Canadian Imperial Bank of Commerce* v. *Canotek Development Corporation* (1997), 35 O.R. (3d) 247 (C.A.)

4. Procedural Requirements

The *Commercial Tenancies Act ("CTA")* does not require any notice to be given to a tenant prior to distraining, nor does the common law; however some leases do. Always check before proceeding.

A landlord him or herself may effect a distress. However, particularly in light of the complexity of the law in this area and the sophistication of tenants in knowing and enforcing their rights, a landlord may be well advised to retain a properly qualified bailiff.

The choice of bailiff will likely be critical to the outcome of the distress. The field is unregulated so be sure you choose your bailiff carefully. The bailiff is the landlord's agent and the landlord becomes liable for the acts of the bailiff. It is important to ensure that the bailiff has proper insurance, and provides an indemnity agreement protecting the landlord in case the bailiff intentionally or inadvertently acts outside the law.

Some of the procedural steps that must be followed include the arcane requirements that a distraint may only be conducted between the hours of sunrise and sunset, and at least until recently, could not be undertaken on a Sunday. In light of the many legislative changes surrounding Sunday shopping and other activities that were formerly prohibited on the Christian Sabbath, this particular requirement is clearly open to challenge.

5. Getting Access

The landlord or its bailiff must gain access to the premises without the use of force - i.e. cannot break into the tenant's premises - cannot use a master key as it wasn't given to the landlord for this purpose therefore it can't be used for this purpose- and that the landlord or its bailiff must at all times ensure that the peace is not breached.

Should the tenant resist the distress, the bailiff must be prepared to withdraw before violence occurs,

and then return when tempers have cooled or the situation has been resolved. Otherwise, the bailiff can attempt to enlist the assistance of the police, who may or may not, be willing to help. Still, experienced bailiffs have dealt with these types of situations many times before and are frequently quite adept at moving a distress forward.

<u>6. Specific Procedures For Levying Distress Once Entry Has Been Achieved</u>

The landlord's distress will be in force at such time as the landlord or its agent takes possession of the tenant's goods. The distress ends when the landlord fails to maintain possession of the distrained goods, intentionally abandons the distress, or when the sale of the goods is completed and the proceeds of sale have been transferred to the landlord.

Section 43 of the *CTA* requires that the amount of the goods seized be reasonable in relation to the arrears and costs that are claimed. Consequently, the landlord or bailiff must have some idea of the value of goods before it begins to seize. If the distress in fact turns out to be excessive, then the landlord will be liable to the tenant for damages.

The key element to commencing and maintaining the distress will be the taking and keeping of possession of the distrained goods. Only goods found on the tenant's premises can be distrained. Once distrained, these goods can be removed and placed in storage. Often though, this is not practical, so the landlord will impound goods, either by cordoning them off, tagging them or designating specific goods or areas of the premises as containing distrained goods.

The difficulty is that this frequently requires almost continuous supervision and can be quite disruptive to the tenant's business, which the landlord may well wish to see the tenant maintain so that the rent can continue to be paid.

Consequently, the practice of so called "walking distraints" has developed. This involves the bailiff identifying and making an inventory of the goods that have been distrained, and then leaving the tenant with the care of these goods for purposes of continuing to use or sell them until such time as

either the rent is paid, or the goods are sold by the bailiff and removed from the premises.

The difficulty lies in the fact that the bailiff has, for all practical purposes, relinquished all control over and therefore possession of the goods, which in theory brings the distraint to an end. The solution seems to be in having some form of agreement between the bailiff or landlord and the tenant, whereby the tenant acknowledges that it has access to the distrained goods as an agent or trustee of the landlord, and any use or sale of the goods is strictly that of a trustee acting on behalf of the beneficiary of the trust, in this case the landlord. This appears to solve most of the problems that are normally associated with walking distraints.

Throughout this entire process, the one thing that both bailiff and landlord must always bear in mind is that if the tenant is excluded from its premises and not allowed to carry on business, then the tenant can claim that the landlord has breached the tenant's right to quiet enjoyment of the leased premises, and thereby terminated the lease. This is likely the last thing the landlord wants, as it destroys the right to distrain. Furthermore, had termination been the landlord's intention, it could have simply elected to do so at the outset and avoided the costs and risk associated with distraining. Therefore, it is important that even where the landlord chooses to change the locks in order to maintain possession over the tenant's goods, the tenant be provided with written notice that this step was taken solely to secure these goods and not to effect termination of the lease, and to inform the tenant that they can always have access to the leased premises during normal business hours in order to be able to continue their operations. Failing this step, the entire lease will be at risk.

7. Section 53 Notices

Section 53 of the *CTA* requires that the tenant be provided with proper notice of the distraint. It will generally be the bailiff who will prepare and serve this notice. Once the distraint has taken place, the tenant will have 5 days in which to pay the arrears and costs, or the landlord will be free to sell the tenant's goods.

This will be a very important decision for the landlord to make. In many cases the purpose of the

distraint may have simply been to "send a message" to the tenant and/or to prompt the tenant to catch up on its rental arrears. Many legal counsel operate on the "24 hour" or "48 hour" rule, whereby they will direct their clients to abandon a distress if the desired result has not been achieved within these times frames. This is because of the perils that the landlord faces in actually going ahead and selling the tenant's goods, which are described below.

8. Inventory

There is no specific requirement for when an inventory of the goods seized by the landlord must be produced, but given that one must be created in order to have the goods appraised - which is a formal requirement under the *CTA* - and perhaps more importantly, given that the tenant may well allege that the landlord took too many chattels or lost or mishandled them, the sooner an inventory is made the better.

When preparing an inventory many bailiffs take photographs or video the goods along with descriptions and serial numbers to accurately identify all of the goods distrained. In addition, it indicates to the tenant that the landlord is serious about the distraint. This can often cause settlement negotiations to progress more rapidly.

9. Elements of an Appraisal

If the landlord elects to complete the sale, then at the end of the 5 day redemption period provided for under the *CTA*, the goods of the tenant must be appraised. Section 53 of the *CTA* requires that a minium of 2 appraisals be obtained. The costs of the appraisals become part of the costs of the distraint. The appraisers must be properly qualified, and do their job in an appropriate and professional manner. They should not be parties related in any way to the landlord or to the landlord's bailiff.

Under Section 53 of the *CTA*, both appraisers are required to complete affidavits to which the inventories noted above must be attached. However, even before undertaking the appraisal, they must first be sworn to appraise the tenant's goods "truly, to the best of their understanding". In many

cases where a tenant later challenges the distraint, the process of the appraisals proves to be the weakest link.

10. What Goods May or May Not Be Distrained

Only property of the tenant may be distrained. However, the term "tenant" is defined in broad terms in the *CTA* to include "a sub-tenant and the assigns of the tenant and any person in actual occupation of the premises under or with the assent of the tenant during the currency of the lease, or while the rent is due or in arrears, whether or not the person has attorned to or become the tenant of the landlord."

Consequently, sub-lessees etc. are not immune from having their goods seized by the landlord. At the same time, Section 32(2) of the *CTA* allows sub-tenants to retake possession of their goods if they swear a statutory declaration that the head tenant has no interest in the goods that have been distrained, and to the extent that the subtenant has paid its share of the arrears to the landlord.

Other than for those parties identified in the definition of tenant above, Section 31(2) of the *CTA* states that as a general rule, goods of third parties cannot be distrained. However, this same section goes on to set out a list of 9 exceptions to the general rule.[3]

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[3] Section 31(2) of the *CTA* states:
"A landlord shall not distrain for rent against the goods and chattels of any person except the tenant or person who is liable for the rent although the same are found on the premises..."
However this section contains 9 exceptions:

1) If an execution creditor has seized goods that are still on the premises the landlord can still distrain against them.
2) A landlord can distrain against the goods of a person if they are on the premises and the person got title to them from the tenant.
3) A landlord can distrain against the goods of a chattel mortgagee regardless of when the mortgage was given and even if the mortgage is registered and the mortgagee has claimed possession of the goods. If the goods are still on the premises the landlord can distrain them.
4) If goods are subject to a personal property security interest such as a General Security Agreement or a debenture under which title to the secured goods is not retained by the lender but is charged or liened in favour of it, the landlord can distrain even if the security holder has perfected its security interest and has seized the goods so long as the landlord distrains before they leave the premises.

5) If a lender uses a form of security interest such as a conditional sales contract, or an equipment lease under which title remains in the lender until the purchase price is paid, the landlord can still distrain the goods but it must pay to the lender that part of the sale proceeds, after deducting reasonable distress costs, that exceeds the value of the tenant's equity interest in the goods. This usually means that the lender has to be paid off before the landlord gets to keep sale proceeds.

6) Note also that where the tenant leases goods under a true equipment or chattel lease that is not intended as a form of financing or security arrangement the landlord can not distrain on the leased goods. A bank that holds security under Section 427 of the *Bank Act* (this usually involves inventory) has priority over a landlord and unless there were arrears at the time the bank takes the security the landlord can not distrain on the affected goods.

7) If a person has taken security in or acquired title to the goods just for the purpose of defeating the landlord's right of distress, the landlord can distrain against the goods.

8) A landlord can distrain the goods of the spouse, child, son or daughter-in-law of the tenant or any other relative of the tenant if the other relative lives on the premises as a member of the family.

9) Goods on the premises owned by any person who gets title from any relative referred to in paragraph 8 above are also subject to distraint. Note that there is another type of exception as well. Under Section 31(3) the goods of a third party that are on the premises where the tenant is the clerk of, or the agent of that other person are also liable to distraint.

One of the biggest hazards facing a landlord is attempting to determine which, if any of the tenant's goods may be the subject of some form of title retention agreement. The landlord's right to distrain only extends as far as the tenant's interest in these types of goods, so where there is either a conditional sales contract or a lease to own arrangement, the landlord may find that there is little to no value in these items that can in fact be realized from a sale.[4]

In addition, where the tenant has granted security over its assets to a secured creditor under the PPSA, the current state of the law is that if the landlord commences its distraint prior to any seizure by a secured party under its security, the landlord will have priority over the secured creditor. Essentially it is a race of the swiftest.[5]

However, the Ontario Court of Appeal has recently held that a landlord's distress completed within 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 its preferred claim under the *Bankruptcy and Insolvency Act.*[6]

Security taken by a bank under Section 427 of the *Bank Act* is treated differently. As soon as the bank registers its security interest with the Bank of Canada, the landlord will loose it rights to distrain, except to the extent of any arrears that may be outstanding up to the date of registration.

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[4] *J.R. Autobrokers Ltd.* v. *Hillcreast Auto Lease Ltd.*, [1968] 2 O.R. 532 (H.C.)

[5] *Commercial Credit Corp. Ltd.* v. *Harry D. Shields Ltd.* (1980), 29 O.R. (2d) 106, affd 32 O.R. (2d) 703 (C.A.)

[6] *Canadian Imperial Bank of Commerce* v. *Canotek Development Corporation* (1997), 35 O.R. (3d) 247 (C.A.)

Therefore, a Section 427 search must also always be made before distraining.

As noted above, one of the other key features of distraint is that the landlord is limited to seizing the chattels, but not the fixtures - including trade fixtures - belonging to the tenant. The distinction between a chattel and a fixture is the subject many cases and the best that can be said is that as a general rule, objects that are fixed or attached to the building will be fixtures, and objects that are moveable and not attached will be viewed as chattels, This, however, is only a basic rule of thumb and not definitive.

When seizing property, the landlord and/or bailiff must also be aware that there is a long list of other specific exceptions, such as perishable goods, money - unless in a container, so often the tenant's cash register is seized intact as this provides the container - and other items such as $2,000.00 in value of "tools of a person's trade". Some of these exemptions have been carved out by the common law. Others are found in statutes, such as the *Executions Act*.

11. Sales Procedures

Before the sale of any of the tenant's goods takes place, it is necessary to conduct a PPSA search. While this will not fully determine if there are goods on lease, goods covered by conditional sales or other title retention agreements, or goods on consignment, this is the minimum step that the landlord must take in order to try to protect its interests.

It is also important to note that anyone except the landlord can purchase goods offered at a distress sale. The "landlord" will include not only the landlord itself but its agents, its affiliates, and its agent's affiliates. This means that the bailiff, as the landlord's agent and the bailiff's affiliates are precluded from purchasing the tenant's goods.

12. What Happens to Sale Proceeds?

After the sale of the tenant's goods has been completed, the landlord must then account to the tenant for the proceeds, and be prepared to account to third parties such as the government, secured creditors and to the court, if required. Therefore, full and complete records of all of the steps taken during the sale process are a must.

Perhaps the biggest concern today for landlords who are considering distraining is the fact that both federal and provincial legislation has created a host of government liens that rank in priority to, and may even create separate liability on the distraining party. This area is considered more fully in the final part of this section. Suffice to say, this is a critical issue, and must be taken into account by any landlord BEFORE and not after the distraint has been commenced.

If after a sale of the tenant's goods has been undertaken and completed there is a resulting surplus of funds, this money should be paid out based on the normal priority to creditors or the tenant.

If there is a deficiency, then the landlord will have a claim against the tenant for this amount and can pursue it in the same way that the landlord would pursue any other debt for rental arrears. Except the landlord may not now terminate for the same rental arrears for which it has just distrained. The landlord must wait for fresh rental arrears to accrue.

13. Illegal and Irregular Distress

When a distress is effected in an improper manner, the error can be characterized as creating either an "illegal" distress, or an "irregular" distress.

An illegal distress is void. It results in the landlord being liable for trespass and the purchaser of the distrained goods does not get title to them. The landlord also becomes liable for all damages suffered by the tenant.

If a distress is irregular and not illegal, the landlord is liable for the damages specifically arising from

the irregularity but the title to the goods does pass to the purchaser and the distress is legally effective.

14. 11 Examples of Illegal Distress

- If there is no landlord and tenant relationship there can be no distress. The most frequent example is where the landlord has terminated the lease or the lease has been surrendered. Note however, that if a lease expires and the tenant remains in possession and goods remain on the premises the landlord can distrain for arrears accrued during the tenancy, and this right remains for as much as 6 months after the expiry, see *CTA* s.41. Another example would be if there is no lease and a mere licence to occupy or use the premises.
- If there is no rent in arrears the distraint is void.
- If the distraint occurs at night, between sunset and sunrise, it is probably void. A distress that occurs on a Sunday or other holiday <u>may</u> also be illegal but there is some question concerning this point.
- If a trustee in bankruptcy has been appointed, a court appointed receiver has been appointed, winding up proceedings have resulted in the appointment of a receiver, or a stay under the *Bankruptcy and Insolvency Act*, or the *CCAA* is in force.
- If the landlord makes an unlawful entry, ie. not by normal and ordinary means, it is illegal.
- If the landlord distrains against goods that are not on the premises in respect of which arrears have arisen (other than where the goods have been fraudulently or clandestinely removed and the distraint occurs within 30 days after the removal), the distress is illegal.
- If the tenant is no longer in possession of the premises its goods cannot be distrained. The tenant is still in possession if its subtenant is in possession and the tenant is no longer in possession if it has assigned the lease.
- If the goods seized are exempt from seizure the distress in respect of those goods is illegal.
- If the bailiff is not authorized to act as a bailiff in the county or district where the premises are situate the distress is illegal.
- If the landlord attempts to effect a second distress on the same goods after abandoning an initial distress, the distress is probably illegal.

- If the tenant tenders the rent arrears before the seizure there can be no distress even if the bailiff fees and legal costs are not tendered unless they are expressed in the lease to be payable as "additional rent".

15. Examples of Irregular Distress

- Excessive distress, where the landlord seizes substantially more goods than are necessary to cover the arrears and the costs.
- Failure to have the goods appraised by two properly qualified appraisers or failure to attach the required affidavits to an inventory of the appraised goods.
- Failure to produce an inventory of the distrained goods or failure to produce the inventory until after the sale.
- Failure to give a copy of the demand, costs and expenses to the tenant.
- Failure to serve notice of the distress on the tenant as required under section 53 of the *CTA* before selling the goods.
- Selling the goods before the expiry of the 5 day period prescribed by section 53.
- Failure to sell the goods for the best price obtainable.
- Selling the goods to the landlord or to a company that it controls.
- Improperly dealing with any surplus.

16. Fraudulent or Clandestine Removal of Goods and Theft

Whenever a tenant attempts to remove its goods from the premises during normal business hours and there are arrears of rent outstanding, the landlord is at liberty to begin to distrain immediately against all of the goods remaining on the premises.

The landlord may also wish to point out to the tenant, and to those helping the tenant, that pursuant to section 50 of the *CTA* the tenant and anyone who assists the tenant to fraudulently or clandestinely remove goods or chattels of the tenant is liable for double the value of the goods so removed. Clearly the landlord can plausibly argue that goods removed, whether in broad daylight, or during a "midnight move", are subject to this penalty and this may help to dissuade the move out.[7]

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[7] In *Cowie Industrial Developments v. National Clearance Warehouse Ltd. (1999), 119 O.A.C. 91, 23 R.P.R. (3d) 182 (CA),* the value of the goods that were fraudulently removed was $500,00.00.

The tenant was held liable for $1,000,000.00 being double the value of the goods.

Where a principal of a tenant corporation assists in the fraudulent removal of goods in an effort to avoid distress, the court may pierce the corporate veil and hold the principals of corporation liable for the penalty under s.50 of the *CTA*.[8]

17. Who Is the Landlord Really Distraining For?

Even when a distress is done properly and goes ahead without incident, the landlord may still find that the proceeds must be handed over to another party, leaving the landlord with little to show for its efforts. There are several reasons.

First, as indicated before, if a bank has taken security under the *Bank Act* and issued the required notice prior to the rental arrears accruing, the bank will have a prior claim to the sale proceeds.

Second, the landlord can only distrain against "chattels", and even then chattels that are leased or on consignment cannot be distrained. As well, once again goods sold under conditional sales contracts can only be distrained to the extent of the tenant's equity interest in them which may be very little. The landlord selling off goods might well find that the sale proceeds are due to another party.

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[8] *1268227 Ontario Ltd. (c.o.b. Seamus O'Brien's) v. 1178605 Ontario Inc. [2001] O.J. No. 3642 (Ontario Superior Court of Justice, September 10, 2001, Croll J.)*

Third, even where the landlord's right to distrain has priority over a secured creditor, there is a risk that before the distraint sale is completed, the tenant may become bankrupt. This too blocks the distress and puts the secured creditor back on top in any priority dispute. In such a case, the goods must simply be handed over to the trustee in bankruptcy. As well, even if the distress sale is completed before the bankruptcy, if the distress occurs within three months of the bankruptcy it will likely be treated as a fraudulent preference. The proceeds will have to be handed over to the trustee in bankruptcy, and the landlord will get little benefit from the distress.[9]

Fourth, and perhaps most insidious, are the statutory liens that arise and take priority over the landlord's interests. The so-called "super liens" for GST, federal income tax etc. have been around for some time. These create a first charge on any monies realized by the landlord. The real difficulty is that clearance certificates detailing the tenant's account(s) are not issued. Consequently, distraint sales must often be conducted "blindly". The odds are that if a tenant is behind in rent, it is probably in arrears elsewhere.

18. *Retail Sales Tax Act*, section 22[10]

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[9] *Canadian Imperial Bank of Commerce v. Canotek Development Corp. supra* footnote 6.

[10] ***Retail Sales Tax Act***, R.S.O. 1990, c. R-31, s.22
Trust for money collected
22. (1) Any amount collected or collectable as or on account of tax under this Act by a vendor shall be deemed, despite any security interest in the amount so collected or collectable, to be held in trust for Her Majesty in right of Ontario and separate and apart from the vendor's property and from property held by any secured creditor that but for the security interest would be the vendor's property and shall be paid over by the vendor in the manner and at the time provided under this Act and the regulations.
Extension of trust
(2) Despite any provision of this or any other Act, where at any time an amount deemed by subsection (1) to be held in trust is not paid as required under this Act, property of the vendor and property held by any secured creditor of the vendor that but for a security interest would be property of the vendor, equal in value to the amount so deemed to be held in trust shall be deemed,
(a) to be held, from the time the amount was collected or collectable by the vendor, separate and apart from the property of the vendor in trust for Her Majesty in right of Ontario whether or not the property is subject to a security interest; and
(b) to form no part of the estate or property of the vendor from the time the amount was so collected or collectable whether or not the property has in fact been kept separate and apart from the estate or property of the vendor and whether or not the property is subject to such security interest.
Same

(3) The property described in subsection (2) shall be deemed to be beneficially owned by Her Majesty in right of Ontario despite any security interest in such property or in the proceeds of such property, and the proceeds of such property shall be paid to the Minister in priority to all such security interests.

....

No distribution without Minister's certificate

(6) Any person described in subsection (5) who distributes any property described in that subsection or the proceeds of the realization thereof without having obtained the certificate required by that subsection is personally liable to Her Majesty in right of Ontario for an amount equal to the amount deemed by subsection (1) to be held in trust, including any interest and penalties payable by the vendor.

From a practical point of view, the most significant governmental "super lien" belongs to the Ontario government for unpaid retail sales tax and other provincial taxes. Effective January 1, 1998, the *Retail Sales Act* and certain other statutes, were amended to extend the trust provisions for unpaid sales taxes to secured creditors. As a result landlords as well as other secured creditors who seize and sell a tenant's goods may become liable to the Ontario government not just for the value of the goods seized, <u>but for the entire amount of tax owed by the tenant.</u> In order to avoid this a landlord MUST obtain a tax clearance certificate before selling any goods.

The Ministry of Finance cannot tell a landlord whether or not there are tax arrears as it would be disclosing confidential information about a taxpayer to a third party. Two courses of action are available. The landlord may distrain against the tenant's goods, and once it has seized the goods the Ministry of Finance will advise of any arrears as the landlord is potentially holding property in trust for the Ministry on account of arrears. The second approach is a more cautious one which takes a few days longer. The landlord calls the Ministry of Finance and advises that it intends to distrain and wants to know if there are any tax arrears. The landlord will be told to do a PPSA search within the next two or three days and if there are arrears the Ministry will have registered a lien by then.

If the tax arrears are greater than the value of the tenant's goods, a distraint is of no advantage to the landlord as the entire proceeds will belong to the Minister of Finance. Note also that where a tenant abandons its premises and leaves its goods behind, the landlord may seize and sell the goods, however, the Minister of Finance takes the position that the proceeds in this case are also held in trust on account of tax arrears.

<u>19. Conclusion</u>

Many landlords have decided to stay away from distraint altogether. After reading the foregoing you will understand why. Still, distress is a valuable self help remedy available to landlords. It can produce results, some landlords like to use it as a method of "getting the tenants attention". Others, notwithstanding the myriad of pitfalls, have been able to complete their distress and realize net proceeds for the landlord.

III FORFEITURE - HOW TO ACHIEVE IT SUCCESSFULLY

1. Introduction

A landlord may, in the event of a default, forfeit the tenant's lease and re-enter the leased premises, all without judicial intervention. The landlord's right of forfeiture is another powerful self-help remedy. However, as a general rule the courts do not look favourably on a forfeiture and will, at least in the opinion of many landlords, grant relief from forfeiture all too readily. The job of the landlord's counsel is to ensure that all the "i"s are dotted and the "t"s are crossed to ensure that the forfeiture is effective. On the other hand, tenant's counsel is charged with the task of poking as many holes in the forfeiture as possible.

2. The forfeiture procedure - General

Events of default which give rise to a landlord's right of forfeiture are broadly divided into two types; monetary (non-payment of rent), and non-monetary. The landlord's forfeiture rights for non-payment of rent are set out in s. 18 (1)[11] of the *CTA*. For non-monetary breaches we must look to section 19(2)[12]. The distinction between monetary and non-monetary breaches is not always as obvious as it may seem at first blush. For example, the non-payment of a security deposit has been

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[11] 18 (1) Every demise, whether by parol or in writing and whenever made, unless it is otherwise agreed, shall be deemed to include an agreement that if the rent reserved, or any part thereof, remains unpaid for fifteen days after any of the days on which it ought to have been paid, although no formal demand thereof has been made, it is lawful for the landlord at any time thereafter to re-enter into and upon the demised premises or any part thereof in the name of the whole and to have again, repossess and enjoy the same as of the landlord's former estate. R.S.O. 1990, c. L.7, s. 18 (1).

[12] 19 (2) A right of re-entry or forfeiture under any proviso or stipulation in a lease for a breach of any covenant or condition in the lease, other than a proviso in respect of the payment of rent, is not enforceable by action, entry, or otherwise, unless the lessor serves on the lessee a notice specifying the particular breach complained of, and, if the breach is capable of remedy, requiring the lessee to remedy the breach, and, in any case, requiring the lessee to make compensation in money for the breach, and the lessee fails 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. R.S.O. 1990, c. L.7, s. 19 (2).

held to be a non-monetary breach.[13]

Section 18 (1) specifically allows the parties to agree to terms other than those in the section. Section 19(2) does not allow the parties to contract out of that section, although Estey CJHC (as he then was) suggested , in *obiter*, in *Mount Citadel Ltd. v. Ibar Developments Ltd.*[14] that it was possible to contract out of this section. The decision has not been generally accepted as correct.

3. Monetary Breaches: Non-payment of rent

Under s. 18 (1) of the *CTA*, the landlord has the right to forfeit the lease and re-enter the leased premises if rent is outstanding for more than 15 days, without the necessity of giving notice. Both landlords and tenants prefer to contract out of this section. Landlords are reluctant to wait such a long period of time and will generally allow no more than five days delay before declaring default. Tenants want notice and an opportunity to remedy the rental default before the landlord may forfeit and re-enter. As always, check the lease carefully before proceeding.

4. Non-monetary Breaches

Under s. 19 (2) of the *CTA*, a landlord must provide a tenant with notice of an alleged breach, setting out a reasonable time to correct the breach if possible and in any case requiring monetary compensation for the landlord's losses stemming from the breach. It is only after this period expires and the tenant fails to comply with this notice that the landlord has a right to forfeit the lease and re-enter the premises or seek a writ of possession.

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[13] *Nationwide Parking Inc. v. Daulat Investments Inc.* (unreported, Ont. H.C., June 15, 1990, Doc. No. Toronto RE 1278/90).

[14] (1976), 14 O.R. (2d) 318 (H.C.)

The notice must clearly and correctly describe the breach[15] and request that the breach be remedied if it is possible to remedy it. The notice should set out any claims to compensation; however, if the landlord is not seeking compensation, then the failure to include a compensation claim in the notice will not invalidate it.[16] Not making a claim for compensation does not necessarily prevent the landlord from seeking damages at a later date. Even if the breach cannot be remedied, the notice must be issued before forfeiture can take place.[17] It must be clear from the notice that the tenancy is in jeopardy: a notice that contemplates the continuation of the landlord-tenant relationship is not valid.[18]

Section 19 (2) states that the landlord must give reasonable time to correct the breach if it can be corrected, and/or make compensation if compensation is sought. The lease may set out what the parties accept as reasonable time for a notice under s. 19(2).

5. Forfeiture and Re-entry

Once the notice period expires and the breach has not been remedied, the landlord may then forfeit the lease and re-enter the premises. The forfeiture must be an act which is not compatible with a continued landlord-tenant relationship.[19] A mere notice is not sufficient.[20] The commencement of an action or application for possession under Part III of the *CTA* has been held to be an act of

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[15] an incorrect description may render the notice invalid: *Holman v. Knox* (1912), 25 O.L.R. 588 at 604, per Sutherland J. (Ont. Div. Ct.)

[16] *Chick'n Treats Inc. v. Woodside Square Ltd.* (1990), 38 O.A.C. 138 (C.A.)

[17] *780046 Ontario Ltd. v. Columbus Medical Arts Building Inc.* (1994), 118 D.L.R. (4th) 609 (Ont. C.A.)

[18] *Re Simpson and Young & Biggin Ltd.* [1972] 1 O.R. 103 (C.A.)

[19] *Winbaum v. Ginou* [1947] O.R. 242 (H.C.)

[20] *Re Simpson and Young & Biggin Ltd., supra*

forfeiture.[21] Changing the locks is the usual and most reliable way to effect forfeiture.[22]

6. Writ of Possession

The landlord may apply to the court under Part III of the *CTA* for a writ of possession. This is a summary procedure which is usually relatively speedy. If unopposed, it might take no more than a few days; and even if opposed, it is not too optimistic to expect a decision in a few months. The writ is a good alternative if physical re-entry is not possible, if it is likely to be unopposed or if the re-entry is not urgent.

Damages for non-payment of rent, or any other loss, may not be claimed on a summary application under Part III of the *CTA*, but only in a separate action.

7. Distress

Distress will not effect termination of the lease. In fact, if the lease has been terminated, distress is no longer available since distress is an incident of the landlord-tenant relationship and termination ends that relationship.

8. Waiver

In any default situation, the landlord must be careful not to do anything that could be interpreted as a waiver or an indication of intention contrary to forfeiture. Some examples of waiver by the landlord of its right of forfeiture following default are:

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[21] *Grimwood v. Moss* (1872), L.R. 7 C.P. 360

[22] though in one unusual case where the premises served as an airport, changing the locks was found insufficient because planes could still land and take off: *Falkowski v. Wilson* (1965) 49 D.L.R. (2d) 490 (Ont. H.C.)

(1) Accepting rent which came due after the default came to the landlord's attention is generally seen as a waiver of the forfeiture. This is so even where the lease specifically includes a "non waiver" provision which states that the acceptance of the rent is without prejudice to and is not a waiver of a forfeiture.[23] Rent arrears, however, may be accepted by a landlord on account for periods prior to the notice.

(2) Merely demanding rent is also considered to be an act which confirms the existence of the lease and acts as a waiver of the landlord's right to forfeiture.[24]

(3) If the breach complained of is the abandonment of the premises, the landlord should not accept the keys to or possession of the premises from the tenant. Such acceptance may be held to be an acceptance of the tenant's abandonment.[25]

(4) By accepting the tenant's abandonment and surrender of the lease the landlord may have waived its right to claim damages for future loss of rent. By sending a notice of default stating that the landlord has accepted the tenant's repudiation and directing the tenant to vacate the premises, a landlord waives its right to claim damages for future loss of rent. [26]

(5) Courts have held that a landlord will be deemed to have waived its right of forfeiture where the landlord brings an action against a tenant for arrears of rent accruing due

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[23] *Mbozos v. Hios* (1982), 36 O.R. (2d) 627 (H.C.), *Royal Inns Canada v. Bolus-Revelas-Bolus* (1982), 37 O.R. (2d) 339 (Ont. C.A.) Note: there are cases that have gone the other way.

[24]*Segal Securities v. Thoseby [1963] 1 Q.B. 887*

[25] *Gulutzan v. McColl Frontenac Oil Co.* (1960), 35 W.W.R. 337 (Sask. C.A.)

[26]*722924 Alberta Ltd. v. Barry Sinn [2002] A.J. No. 3, 2002 ABPC 2, Provincial Court of Alberta, January 3, 2002, Hess, Prov. Ct. J.*

following a breach.[27]

[27] *Straus Land Corporation Ltd., supra, note 2; Malva Enterprises Inc. v. Rosgate (1993), 14 O.R. (3d) 481 (C.A.); Dendy v. Nicholl (1858), 140 E.R. 113; Penton v. Barnett, [1898] !.Q.B. 276.*

(e) Also, where the landlord distrains for rent, the landlord will be deemed to have waived its right of forfeiture. [28]

9. Mitigation

Once the landlord forfeits the lease and re-enters the leased premises it may also sue for the rent due over the balance of the lease term. The landlord must provide the tenant with written notice of its intention to sue, setting out the damages claimed.[29] In addition to the present value of expected future rent, damages may also be claimed for other losses, including costs of re-renting the premises. The landlord may also claim damages for such things as an unauthorized renovation[30]. The measure of the damages for the breach will usually be the injury to the value of reversion - i.e. the projected loss to the value of the property[31].

Following termination the landlord must act reasonably to mitigate its loss. However this does not mean that the landlord owes a "duty" to the tenant to mitigate its loss. Professor Waddams explains the landlord's mitigation obligation as follows:

> "The [landlord] is barred from recovering in respect of loss that could have been avoided by acting reasonably. What is reasonable has been called a question of fact depending on the particular circumstances of the case. However, as with remoteness, a finding that the

[28] *Ward v. Day (1863-64) 4 B.& S. 337*

[29] *Highway Properties Ltd. v. Kelly, Douglas & Company limited* [1971] S.C.E. 562

[30] *Finnegan's Ltd. v. Azores Wharf Ltd.* (1981), 99 A.P.R. 448 (Nfld. T.D.)

[31] *Gooderham & Worts v. C.B.C.*, [1947] 1 W.W.R. 1, (P.C.)

[landlord] ought to have mitigated is not a simple question of fact because it involves a legal conclusion. In case of doubt, the [landlord] will usually receive the benefit, because it does not lie in the mouth of the [tenant] to be over-critical of good faith attempts by the plaintiff to avoid difficulty caused by the [tenant's] wrong."[32]

Provided the landlord makes reasonable, good faith efforts to re-rent the premises it will have mitigated its loss. The issue of mitigation becomes more complex where the default is in a multi-unit building or shopping centre. Simply put, where the landlord has multiple vacancies it is not obliged to rent any particular premises first. Furthermore, where the landlord re-rents the premises of a former tenant it is suing for future loss of rent, the former tenant may not be entitled to the benefit of the mitigation in reducing the landlord's future loss of rent claim, if there are still vacant units.

[32] *The Law of Damages* (Looseleaf Edition) S.M. Waddams, Canada Law Book, p. 15-7.

In *Apeco of Canada Ltd. v. Windmill Place*[33], the Supreme Court of Canada held that in order for the tenant to receive the benefit of the landlord's mitigation there must be a connection between the new tenant and the former tenant's default. If the landlord had other units which it could have leased to the new tenant, then it is said to be an independent transaction which in no way arose out of the breach of lease by the former tenant and therefore the former tenant does not receive any benefit from that transaction. [34]

10. Relief from Forfeiture

The tenant has the right under s. 20(1)[35] of the *CTA* and s. 98 of the Ontario *Courts of Justice Act* (the "CJA"") to apply to the Ontario Superior Court of Justice for relief from forfeiture. The parties cannot contract out of s. 20 (1), see section 20 (6).

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[33]*Apeco of Canada Ltd. v. Windmill Place* [1998] 2 S.C.R. 385

[34]For examples of the application of this principle see *759418 Ontario Inc. v. 690352 Ontario Ltd.* [1992] O.J. No. 641 and *Delray Professional Arts Inc. v. Isaac* [2001] O.J. No. 5166 at paragraphs 55 -60.

[35] Relief against forfeiture
20. (1) Where a lessor is proceeding by action or otherwise to enforce a right of re-entry or forfeiture, whether for non-payment of rent or for other cause, the lessee may, in the lessor's action, if any, or if there is no such action pending, then in an action or application in the Ontario Court (General Division) brought by the lessee, apply to the court for relief, and the court may grant such relief as, having regard to the proceeding and conduct of the parties under section 19 and to all the other circumstances, the court thinks fit, and on such terms as to payment of rent, costs, expenses, damages, compensation, penalty, or otherwise, including the granting of an injunction to restrain any like breach in the future as the court considers just. R.S.O. 1990, c. L.7, s. 20 (1).

If the forfeiture is for a breach other than the non-payment of rent, often the slightest procedural mistakes by the landlord may prove fatal. If the requirements as to notice and period for compliance are not complied with, the courts may use that as the basis for granting a reprieve from forfeiture to the tenant on a relief from forfeiture application In *780046 Ontario Inc. v. Columbus Medical Arts Building,*[36] Laskin J.A. explained the reason for this rule as follows:

> "Notice is a protection of the tenant. Its purpose is to warn the tenant that its leasehold interest is at risk and to give the tenant an opportunity to preserve that interest by remedying the breaches complained of and, where necessary, by compensating the landlord. Because courts have not looked favourably upon the remedies of re-entry, forfeiture, and termination they have insisted that landlords strictly comply with the notice requirement in s. 19(2) of the Act."

Forfeitures may also be set aside if they are illegal for reasons other than inappropriate notice, such as the lease not giving the landlord the right to forfeit the lease for the breach alleged or that the tenant was not given sufficient time to remedy the breach or give financial compensation.[37] The tenant may also argue that the landlord waived its right to forfeit.[38] The outcome of such arguments will depend on the facts in each case.

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[36]*Supra* at p. 616 D.L.R.

[37]*Re Industrial Propane Inc. and Cooper* (1984), 48 O.R. (2d) 321.

[38]*Mbozos v. Hios (supra).*

Where the landlord has complied with all procedural and substantive requirements, a court may still grant relief from forfeiture. The courts are particularly concerned to ensure that landlords do not use the forfeiture provisions to get out of their long-term leases merely because the lease is no longer advantageous to them. Thus forfeiture may be set aside for breaches that are merely technical and cause no loss to the landlord.[39] However, relief from forfeiture will almost never be granted unless the tenant is willing, ready and able to fully compensate the landlord for its losses.[40]

If the tenant made significant improvements to the premises so that the landlord reaps a windfall, or if the financial hardship to the landlord is much smaller than what the hardship to the tenant would be if the lease was forfeited, relief is also often forthcoming.[41]

The tenant's actions will also be examined: ie. tenants that breach the lease flagrantly and repeatedly,[42] or for a long time after they were warned are less likely to obtain relief.[43] Tenants also must come to court with clean hands, for example in *461 King St. W. v. 418 Wellington Parking*[44] where the tenant refused other tenants access to the parking lot thereby threatening the landlord's business, relief from forfeiture was refused.

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[39] *Re Hurontario Management Services Ltd. and Menechella Brothers Ltd.* (1983), 41 O.R. (2d) 348 (C.A.); *York Condominium Corp. No. 26 v. Becker Milk Co.* (1982), 37 O.R. (2d) 679 (Co. Ct.)

[40] *Re Rexdale Investments*, [1967] 1 O.R. 251 (C.A.)

[41] *Re Koumoudouros and Marathon Realty Co.* (1978), 21 O.R. (2d) 97 (Div. Ct.)

[42] *Jeans West Unisex Ltd. v. Hung* (1975), 9 O.R. (2d) 390 (H.C.)

[43] *Re Jawanda and Walji et al* (1975), 10 O.R. (2d) 527, at 531 (Div. Ct.)

[44] (1994), 40 R.P.R. (2d) 220 (Ont. Gen. Div.), see also *FPJ Properties Ltd. v. Parkway Finch Food Services Ltd.* (1990) 15 R.P.R.I. (Ont. Co. Crt.) where the tenant forcibly re-entered the premises after the bailiff had taken possession, this disentitled the tenant to relief from forfeiture.

Conversely, tenants that breached the lease inadvertently, or who seriously attempted to correct the breach are more likely to get a reprieve.[45]

11. Cost on Relief From Forfeiture Applications

[45]*Conwest Exploration Co. Ltd. et. al. v. Letain,* [1964] S.C.R. 20.

In addition to paying the rent and other losses incurred by a landlord, a tenant who is successful on a relief from forfeiture application will often be required to pay the landlord's legal fees in opposing the application on the substantial indemnity scale (formerly solicitor client costs). At first glance this may seem anomalous, however, it is not. A court will only need to grant relief from forfeiture where there has been a forfeiture. If the tenant proves that the landlord wrongfully terminated, then it does not require relief as the lease was not properly forfeited. [46] However, where the forfeiture is upheld by the courts, and the court exercises its equitable jurisdiction to "give the tenant a break" provided it pays up its rent, then the landlord is blameless, as its forfeiture was upheld by the court, and it ought to have its costs paid in full.[47]

IV ESTOPPEL - HOW TO RECOGNIZE IT

The equitable principle of estoppel, and its close cousin waiver, which we have already discussed in the context of forfeiture, frequently come into play in commercial leasing. The reason is that commercial landlord and tenant matters generally involve long term relationships. During the course of this relationship much is said and done which may have the effect of altering the landlord's and the tenant's legal relationship.

1. Equitable Estoppel

Equitable estoppel, like most equitable principles, is rooted in fairness. Equitable estoppel arises when the parties, in our case the landlord and the tenant, have dealt with each other on a basis which varies from the lease and it would be unfair for one of the parties to now change the established basis

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[46]See *780046 Ontario Inc. v. Columbus Medical Arts Building*, supra at page 467.

[47]See *Gleneagle Motors Ltd. v. Finns Kerrisdale Ltd.* (1980) 116 D.L.R. (3d) 617 at 628 (B.C.S.C.)

for dealing with each other and begin to insist on the strict application of the lease. It is not uncommon for one of the parties, well after the tenancy has started, to read the lease closely and discover that the parties have not been conducting themselves in accordance with the terms of the lease. What then?

The doctrine of equitable estoppel, has its origins in an old English landlord and tenant case known as *Hughes* v. *Metropolitan R.R. Co.*[48] In that case the landlord gave notice to the tenant to make certain repairs within six months. Following the notice the parties entered into negotiations for several months which ultimately failed. The tenant then proceeded to make the required repairs but was unable to do so within the original six-month period stipulated by the landlord's notice. The landlord moved to forfeit the lease six months after the first notice. It was the tenant's position that the six month period for repairs ran from the date on which the negotiations broke off. The court agreed with the tenant:

> "... it is the first principle upon which all Courts of Equity proceed, that if the parties have entered into definite and distinct terms involving certain legal results -- certain legal penalties or legal forfeiture -- afterwards by their own act or with their own consent enter upon a course of negotiation which has the effect of leading one of the parties to suppose that the strict rights arising under the contract will not be enforced, or will be kept in suspense, or held in abeyance, the person who otherwise might have enforced those rights will not be allowed to enforce them where it would have been inequitable having regard to the dealings which have thus taken place between the parties."[49]

The essential factors giving rise to an equitable estoppel are set out in the often quoted case of

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48 (1877), 2 App. Cas. 439

49 Ibid at 448

Greenwood v. Martins Bank Ltd.[50] and are as follows:

(1) A representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation was made.

(2) An act or omission resulting from the representation, whether actual or by conduct, by the person to whom the representation was made.

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50 [1993]A.C. 51

(3) Detriment to such person as a consequence of the act or omission.[51]

20. Detrimental Reliance

The third factor holds the key to equitable estoppel and is often referred to as the need for "detrimental reliance". This occurs where one of the parties has relied on the words or conduct of another and changed their position to their detriment, then the other party will not be permitted to revert to their previous position. When reviewing cases involving equitable estoppel one will find that without detrimental reliance the claim is rarely successful. It is also worth noting that the mere fact that money has been paid does not in itself amount to a change in position or detrimental reliance[52].

30. Estoppel by Conduct and by Convention

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51 Ibid at 57

52 *Hydro Electric Commission of Township of Napean v. Ontario Hydro,* (1982), 132 D.L.R. (3d) 193 (Ont. S.C.).

Recent cases have identified different forms or types of estoppel which have evolved from the root concept of equitable estoppel and have applied them to landlord and tenant cases. A good example is the recent British Columbia case of *Canacemal Investment Inc.* v. *PCI Realty Corp.*[53] which identified two kinds of estoppel, estoppel by convention and estoppel by conduct. In *Canacemal*, the landlord had incorrectly under billed a tenant for its proportionate share of taxes throughout the term of the lease. The tenant argued that since both parties were mistaken concerning the rentable area of the ground floor of the shopping centre (which impacted the calculation of the tenant's proportionate share of taxes) the landlord was estopped from requiring the tenant to pay more than what had been billed.

4 . Estoppel by Convention

The first form of estoppel which the court discussed was estoppel by convention. The court has stated the principle as follows: When parties have acted upon the agreed assumption that a given state of facts is accepted between them as true, then each will be estopped against the other from questioning the truth of the state of facts so assumed, but only if the party claiming the benefit of the estoppel has relied on the assumption to its detriment. A considerable degree of formality, or at least conscious dealing between the parties must exist in order to create a convention to replace the actual facts as the basis of the transaction. If a party has reason to know of the inaccuracy of the assumed facts, the doctrine is not available.

In the *Canacemal Investments* case, the parties did deal with each other on the agreed upon assumption that the proportionate share calculation was correct. However, there was no detrimental reliance. The tenant had not changed its position in any detrimental way as a result of a mutual assumption of an incorrect state of facts. Remember, the mere fact that money has been paid does not in itself amount to detrimental reliance.

5 . Estoppel by Conduct

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[53] [1999] B.C.J. No. 2029.

The court also held that there was no estoppel by conduct. After reviewing the three point test from the *Greenwood v. Martins Bank Ltd.* case, the court again found there had not been any detrimental reliance. Moreover, there was no representation to the tenant and there was no intentional alteration of legal relations. Where both parties act under a mistake as to one party's legal rights, courts will not give effect to estoppel by conduct. The mistake must amount to a representation intended to affect the legal relations between the parties. Note that what the court called estoppel by conduct is not very different from equitable estoppel.

6 . Promissory Estoppel

Equitable estoppel is based on the principle that a person is precluded from retracting a statement upon which another has relied. Originally this was confined to statements of fact or representations by words or conduct of past or present facts that induced the other person to act or change their position in reliance on the representation. However representations or promises about future events were, originally, not considered capable of founding an estoppel. This changed after Lord Denning's decision in *Central London Property Trust Ltd. v. High Trees House Ltd.* [54]. Today "promissory estoppel" is well established.

Promissory estoppel arises where one party has by words or conduct made to the other a promise or assurance which was intended to affect the legal relations between them and to be acted on accordingly. Once the other party has taken the promising party at its word and acted on it, the promising party cannot afterwards be allowed to revert to the previous legal relations as if no such promise or assurance had been made by him. He must accept their legal relations subject to the qualification which he himself has so introduced, even though it is not supported in point of law by any consideration, but only by his word.[55] In the *Central London Property v. High Trees* case Lord

54 [1947] 1 K.B. 130

55 *John Burrows Ltd. v. Subsurface Surveys Ltd.* [1968] S.C.R. 607 at 615

Denning held, *obiter*, that a landlord, having promised to reduce rent payable under a lease was bound by his promise and could not subsequently demand the rent originally due.

In *Long* v. *Inter-Habitation Inc.*,[56] the court applied the principle of promissory estoppel in a landlord and tenant matter involving the payment of operating costs. In that case the tenant had only paid base rent and not operating costs, as required by the lease, for a period of over 7 years. This came as a result of negotiations with the landlord relating to the landlord permitting another store in the plaza to sell baked goods in competition with the tenant. The landlord promised not to charge operating costs to compensate for the increased competition, however the lease was never amended. When the property was purchased, the course of conduct established between the previous tenant and the previous landlord was held to be binding on the new owner of the property even though the new owner knew nothing about the variation of the payments.

7. Mistake and Rectification

Another equitable principle which arises in landlord and tenant matters which may be used to resist a claim is the equitable principle of rectification of a mistake in the lease. In order to succeed on a claim for rectification one must convince the court that the parties had an agreement but they did not write it down correctly.

In *HF Clark Limited v. Thermidari Corp. Limited,*[57] Justice Brooks JA, in an often quoted passage, sets out the equitable principle of rectification as follows:

> "When may the court exercise jurisdiction to grant rectification? In order for a party to succeed on a plea of rectification it must satisfy the court that the parties, all of them, were in complete agreement to the terms of their contract but wrote them down incorrectly. It is not a question of the court asking to speculate on the parties

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56 [1999] O.J. No. 3305

57 [1973] 33 DLR 3d 13 (Ont. C.A.)

> intention, but rather to make an inquiry to determine whether the written agreement properly records the intention of the parties as clearly revealed in their prior agreement. The court will not write a contract for businessmen or others but rather through the exercise of its jurisdiction to grant rectification in appropriate circumstances, it will reproduce their contract in harmony with the intention clearly manifested by them, and so defeat claims or defences which would otherwise unfairly succeed to the end that business may be fairly and ethically done.[58]

In deciding this question, the court does not look at what the parties today think the provision means or what one of the parties intended it to mean. The court must decide what, if anything, the parties agreed to at the time the agreement was made. For example a situation where a claim for rectification may succeed is where the offer to lease differs from the lease ultimately signed by the parties. One of the parties could claim rectification of the lease so that it conformed with the offer and the offer would generally be good evidence of what the parties agreed to at the time.

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58 Ibid at 18.

The decision in *Strategeas v. Lloyd Parish Holdings Limited*[59] provides an interesting glimpse into the law of rectification. In this case the tenant purchased a restaurant business in 1981. The purchase agreement provided that the tenant would enter into a lease in the "usual form". The tenant signed a Dye and Durham lease form which was reviewed by his lawyer prior to signing. Dye and Durham's lease form grants the landlord a right to terminate the lease in the event the property is sold. In 1990, nine years after the lease was signed, the landlord found a buyer for its property and relying on the termination right in the lease gave notice of termination. The tenant applied to have the lease rectified.

The court found that the termination clause could not be considered a usual covenant. The clause was found to be completely contradictory to the granting of the lease as it gave the landlord the power to destroy the tenant's investment in the restaurant. The court went on to find that given the importance of the clause, the landlord's solicitor had an obligation to point out the clause to the tenant's solicitor and not just assume that the tenant was aware of the clause and had accepted it. It is indeed unusual for a court to suggest that the landlord's solicitor ought to have drawn the tenant's solicitor's attention to the termination clause. What this demonstrates is that equity is about fairness and the courts will often stretch principles in order to ensure a fair result.

V. SELF HELP REMEDIES

The remedies of forfeiture and distress, discussed above, are the main "self help" remedies used by landlords. There are a number of less important provisions which often appear in leases that are self help remedies available to a landlord, which will be touched on briefly. However, before we review these lesser remedies, there is one self help remedy which tenants like to use, namely withholding rent and claiming set off.

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59 (1991), 17 R.P.R. (2d) 293 (Ont. Ct. (Gen. Div.))

1. Set off by tenant

The most common tenant self-help remedy is the withholding of rent. This is permitted under section 35 of the *CTA*, which simply provides: "A tenant may set off against the rent due a debt due to the tenant by the landlord." On the other hand landlord's often protect themselves against this provision by including a "no set-off" provision in the lease such as " Rent shall be paid **without deduction, set-off or abatement**."

Can a tenant withhold rent and claim a set-off in the face of a no set-off clause? As a general rule, the answer is no. The court will enforce a no set-off clauses, except where a judge finds that it would be, manifestly "unjust", or "inequitable", or "unconscionable" to allow a landlord to collect its rent without taking into account the claims of the tenant. This is known a "equitable set-off".

Not every claim by a tenant will qualify for an equitable set-off. While judges have a broad discretion, as a practical matter, one can expect that they will override a lease and order equitable set-off in a fairly narrow band of cases. The best way to understand equitable set off is to compare *Mayfair Tennis Courts Ltd. v. Nautilus Fitness & Racquet Centre Inc.*[60] where the court did not allow the tenant's claim for equitable set-off with *Manufacturers Life Insurance Co. v. Firstbrook, Cassie and Anderson Ltd.*[61] where the claim succeeded.

In the *Mayfair Tennis* case, the tenant, Nautilus, leased space in two Mayfair Tennis clubs for its fitness centres. In the year prior to the expiry of the Nautilus leases, Nautilus claimed that Mayfair intended to operate its own fitness clubs in the former Nautilus premises after the leases expired, and as such began soliciting Nautilus' customers. Following the expiry of the leases, Mayfair sued Nautilus for unpaid rent. Nautilus claimed a set-off against the rent for its loss of business as a result

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[60] [1996] O.J. No. 1358.

[61] [1999] O.J. No. 4736.

of Mayfair's solicitation of Nautilus customers.

The court found that while Nautilus was free to pursue a claim against Mayfair for the wrongful solicitation of its customers, the claim was not sufficiently tied to the tenant's obligation to pay rent as to override the no set-off clause in the lease and qualify for an equitable set-off.

In the *Manufacturers Life* case, the tenant had for a number of years disputed the landlord's calculation of additional rent charges. The lease required the landlord to provide an auditor's report verifying the additional rent charges, which it never did. Relying on the no set-off clause in its lease, the landlord claimed it was entitled to its rent even though the tenant claimed set-off for overpayment of additional rent charges, which overpayment had yet to be proven in court.

The court found that there was strong evidence of overcharges although the final amount had not been established. Furthermore, the landlord had breached its lease by failing to deliver an independent auditors report and year end reconciliations. As a consequence the landlord could not rely on other provisions in the same lease, and specifically the landlord could not rely on the provisions which limited the tenant's right to set-off. The court held that it would be manifestly unjust to allow the landlord to recover its rent in full in the face of the evidence of overcharges and the landlord's breach of the lease.

One can therefore conclude that a court may permit an equitable set-off where:

a) there is evidence that the landlord breached the lease; and

b) the amounts claimed by the tenant arise directly out of the lease and not from a collateral or related matter.

2. The Right to Cure Tenant Defaults

Most commercial leases contain provisions allowing the landlord to cure the defaults of the tenant without effecting a termination of the lease. These provisions usually further provide that any costs incurred by the landlord in curing such defaults are the responsibility of the tenant and may be recovered by the landlord as additional rent under the lease. For example, where the tenant, after proper notice from the landlord, has failed to carry out the necessary repairs required of it under the lease, the landlord may elect to enter the premises and make the necessary repairs. The costs of the repairs would be chargeable to the tenant as additional rent under the lease, and if not paid, the tenant would then be in default of its rental obligations under the lease. This provides the landlord with a wider scope of remedies and simpler notice requirements if it then elects to terminate the lease.

3. The Right to Re-Let on the Tenant's Behalf

Most commercial leases also provide that upon default, the landlord may re-enter the premises without terminating the lease and re-let the premises on behalf of the tenant. Despite having this right, it is rarely used as a court may find that the lease was terminated on the re-letting because the new lease was on terms and conditions inconsistent with, or that altered the original tenant's obligations under the original lease (such as extending beyond the term of the original lease). The result would be the landlord's loss of its right to claim damages for loss of the benefit of the lease for its term.

Coupled with the landlord's right to re-enter and re-let is often the landlord's right "to make such alterations to the premises as are necessary in order for tenant to re-let the premises, the costs of which are then chargeable to the tenant." This is not a blanket right for the landlord to effect any alterations it wishes, as the courts will impose a reasonableness standard on the landlord and will look to see if the alterations could have been reasonably foreseen or contemplated by the tenant as necessary for the landlord to re-let the premises.

4. The Right to Appoint a Receiver

Occasionally, commercial leases will provide that on an event of default, such as non-payment of rent, the landlord will have the right to appoint a receiver. This is rarely done due to the exposure

of the landlord to liability for the acts of the receiver and the fact that landlords are not in the business of running tenants' businesses.

5. The Right to Act as Attorney of the Tenant

On the sale or re-financing of leased property, the landlord will generally require estoppel certificates from its tenants as a condition of the closing of the transaction. Most leases provide that the tenant must deliver to the landlord estoppel certificates within a certain number of days from the date requested by the landlord. To ensure that they are delivered in time and do not delay the landlord's closing of its transaction, many leases provide that if the tenant fails to execute and deliver the estoppel certificate to the landlord as required under the lease, the landlord may execute the estoppel certificate as attorney for the tenant.

6. The Landlord as a Secured Creditor

It is common these days for landlords to take a security interest in the property of the tenant to secure the tenants obligations under the lease. The benefit of taking a security interest in the property of the tenant is that if properly drafted and registered in accordance with the provisions of the *Personal Property Securities Act*, upon bankruptcy of the tenant, the landlord will be a secured creditor for the full amount of the tenant's debt under the lease otherwise, upon bankruptcy, the landlord is a preferred creditor for 3 months accelerated rent and an unsecured creditor for the balance of the debt of the tenant, as provided for under the *Bankruptcy and Insolvency Act*.

VI PIERCING THE CORPORATE VEIL

1. Strategies where a tenant has no assets

Landlords all too often find themselves with a tenant which owes rent, but has no assets or income. In this circumstance a landlord may want to consider whether it can prove that there has been:

a. an equitable assignment of the lease to an entity or person which has assets or income; or

b. a wrongful interference with the lease by a third party, which interference may result

in the third party being liable to the landlord for its loss.

On this same topic, tenants will want to know how to ensure that their corporate structure stands up and that the corporate veil is not pierced?

2. Equitable Assignment of Lease

In some instances the landlord may successfully claim that there has been an "equitable assignment" to an entity which has assets or income, in which event this entity becomes liable to the landlord for the rent due under the lease. In order to understand equitable assignment, one must understand the difference between a sublease and an assignment. Under a sublease the tenant parts with less than the whole of the term of its lease. Typically a sublease will exclude the last day of the term of the head lease. Under a sublease there is no privity of contract or privity of estate between the landlord and the subtenant.

Under an assignment of a lease, the tenant parts with the whole term, or more than the term of the lease, so that the tenant has no reversion. In this instance there is still no privity of contract between the landlord and the assignee, but now there may be privity of estate between them. Where there is privity of estate the landlord may be able to sue the assignee for the rent owing over the unexpired term of the lease[62]. The landlord may still sue the original tenant/assignor under its covenant to pay rent found in the lease.[63]

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[62] *Selby v. Robinson* (1865) 15 U.C.C.P. 370 (C.A.).

[63] *Barmond Builders LTD. v Mark 3 Investment Corp.* (1993) 32 R.P.R. (2d) (Ont. Gen. Div.) In this case Rapson J. found there had been a permitted assignment to a related corporation as contemplated by the lease and found both the lessee named in the lease and the equitable assignee liable. Although the lessee had assigned the term it remained liable on its

covenant to pay rent.

The court may find an equitable assignment of the lease where the tenant is a shell corporation owned and controlled by an entity whose business is carried on from the leased premises. Particularly where there is no sub lease and there is no clear distinction between tenant and the occupant of the premises. For example, where a law firm or accounting firm or any other business incorporates a company to hold the lease, but thereafter the firm or business pays rent and deals with the landlord directly and in its own name then there may be said to have been an equitable assignment of the lease from the tenant to the actual occupant[64]. By accepting rent from the occupant and treating the occupant as a tenant, the landlord accepts the assignment.

If there has been an "equitable assignment" of the lease, thereby creating privity of estate between the landlord and the equitable assignee, the equitable assignee may not only be liable for unpaid rent but also for future rent due over the unexpired term of the lease.

Counsel acting for a tenant who wishes to ensure that its corporate structure is enforceable, must emphasize the importance of; the corporate tenant having a bank account, communications with the landlord being in the name of the corporate tenant, having sub-leases which comply with the head lease between the corporate tenant and the entities carrying on business in the premises, the subtenants paying rent to the tenant and the tenant paying the rent to the landlord.

3. The Tort of Intentional Interference with Contractual Relations

Where the tenant is a shell corporation without assets, the landlord may in the right circumstances be able to sue the principals of the corporate tenant for intentional interference with contractual relations. See *Torgan Enterprises Ltd. v. Contact Arts Management Inc.*[65] where a fellow member

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[64] For example see *Bengro Holdings Inc. v. Tax To Go Inc.* [1996] O.J. NO. 2242 QL) (Gen. Div.).

[65] [1997] O.J. No. 2759 (QL) (Gen. Div.)

of the bar was ordered to pay damages in excess of $400,000.00.

Elements of the tort of intentional interference with contractual relations are set out in *Ontario Store Fixtures Inc. v. Mmmuffins Inc.*[66]:

1. an enforceable contract - in our case a lease;
2. knowledge of the plaintiffs contract - the officers and directors have signed the lease on behalf of the tenant corporation;
3. an intentional act on the part of the defendant to cause a breach of the contract - the principals of the tenant corporation will stop paying rent and abandon the leased premises. The tenant corporation has no ability to pursue its subtenants for the rent and it will have no other income or assets to satisfy its liability under the lease
4. wrongful interference on the part of the defendant - the intentional act becomes a "wrongful interference" when it lacks *bona fides* because it is not done in the best interests of the corporate tenant, but advances the personal interests of the principals or a related entity. The principals move to new premises for a better financial deal, however, the better deal does not benefit the corporate tenant as none of the savings flow through to the corporate tenant. The principals keep all the benefit for themselves.
5. resulting damage - the damage to the landlord is the loss of rent , including rent over the unexpired term of the lease plus its cost of finding a new tenant. As this is an action in tort the landlord must mitigate its loss by making reasonable efforts to re rent the premises.

In the *Torgan Enterprises* case, a lawyer was found liable to the landlord for inducing the corporate tenant to breach its lease. The defendants claimed they stopped paying rent and vacated the leased premises because of a large number of unremedied problems they had with the building. The court found that the defendants never told the landlord they would leave if their complaints were not dealt with and found the real reason they moved was a better financial deal for the lawyer. The court found

[66] (1989) 70 O.R. (2d) 42 (H.C.)

the lawyer caused the corporate tenant to breach its lease so that he could get a better rent deal which was of no benefit to the corporate tenant.

4. "In Trust for a Corporation to Be Incorporated"

The *Business Corporations Act*[67] deals with pre incorporation contracts. It provides that until a pre incorporation contract is adopted by a corporation, the original contracting party is personally bound. The section reads as follows:

> 21. (1) Except as provided in this section, a person who enters into an oral or written contract in the name of or on behalf of a corporation before it comes into existence is personally bound by the contract and is entitled to the benefits thereof.

Where the company is incorporated and subsequently adopts the lease, either expressly or by its action or conduct, such as paying the rent, then the original contracting party is no longer personally liable:

> 21 (2) A corporation may, within a reasonable time after it comes into existence, by any action or conduct signifying its intention to be bound thereby, adopt an oral or written contract made before it came into existence in its name or on its behalf, and upon such adoption,
>
> > (a) the corporation is bound by the contract and is entitled to the benefits thereof as if the corporation had been in existence at the date of the contract and had been a party thereto; and
> > (b) the person who purported to act in the name of or on behalf of the corporation ceases, except as provided in subsection (3), to be bound by or entitled to the benefits of the contract.

67 R.S.O. 1990, c. B.16, s. 21.

Where it is unclear whether or not the lease was adopted by the corporation, the landlord may apply to the court to determine liability:

> 21 (3) Except as provided in subsection (4), whether or not an oral or written contract made before the coming into existence of a corporation is adopted by the corporation, a party to the contract may apply to a court for an order fixing obligations under the contract as joint or joint and several or apportioning liability between the corporation and the person who purported to act in the name of or on behalf of the corporation, and, upon such application, the court may make any order it thinks fit.

However, where it is expressly stated that the contract is in trust for a company to be incorporated and without personal liability, and no company is ever incorporated, then you may have an unenforceable lease.

> 21 (4) If expressly so provided in the oral or written contract referred to in subsection (1), a person who purported to act in the name of or on behalf of the corporation before it came into existence is not in any event bound by the contract or entitled to the benefits thereof.

Note the occupant of the premises will be liable for occupation rent for the premises however the other terms of the lease will be unenforceable and the landlord will have no claim for loss of future rent should the "occupant/tenant" quit the premises.

5. CONCLUSION

We have tried to highlight and alert both landlord's and tenant's counsel to the issues and pitfalls they

may encounter in the enforcement of commercial landlord and tenant remedies. Whether the economy is hot or cold we need to be aware of the pitfalls and the many peculiarities that haunt commercial leasing remedies.

When a client seeks to exercise its commercial leasing remedies, whether it is a landlord looking to; distrain, terminate a lease or pierce the corporate veil so it can collect rent from a third party, or a tenant who wishes to withhold rent or ensure that its corporate structure will withstand the landlord's attacks, it is important that counsel become involved in the process at any early stage in order to assist the client in navigating around the pitfalls. Unfortunately, clients all too often do not consult counsel until matters are well advanced and they have run into trouble.

Clients who find themselves in trouble because they don't know their way around commercial landlord and tenant remedies are a source of business. Lawyers who get themselves into trouble because they don't know their way around commercial landlord and tenant remedies, is something we hope this paper will help avoid.