Daoust Vukovich Baker-Sigal Banka LLP
BARRISTERS & SOLICITORS

"Implied Waiver by Landlord - An Unexpected Result"

By: Jeanne Banka with F. Baker-Sigal
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20 Queen Street West, 6th Floor, Toronto, Ontario M5H 3R3
Tel.: 416-597-6888 Fax: 416-597-8897 E-mail: general@dvbb.com Web: www.dvbb.com

IMPLIED WAIVER BY LANDLORD - AN UNEXPECTED RESULT

Who has not encountered the following situations?

1. A tenant who has been in arrears in paying rent receives a notice of default from the landlord, threatening termination if the arrears are not paid. Ignoring the notice, the tenant pays the following month's rent, which the landlord accepts on a "without prejudice" basis. Shortly thereafter, the landlord, having located a better tenant, purports to terminate the lease on the basis of the earlier rental default.

2. The landlord has been receiving monthly rent cheques from the tenant corporation. However, one month the cheque comes in from a different corporate entity. The landlord notifies the tenant in writing that the landlord is depositing the cheque on a "without prejudice" basis and that such deposit is not to be construed as acceptance by the landlord of any assignment of the lease.

3. The lease states that a default is deemed to have occurred if the tenant has not paid percentage rent during any two consecutive years of the term. The tenant has failed to pay percentage rent for years and the landlord has taken no action in respect thereof. The landlord now has an opportunity to lease the premises to a highly desirable tenant whose superior operating style will guarantee not only the payment of percentage rent to the landlord but will also increase traffic in the mall. The landlord now serves the existing tenant with a notice of default, citing the failure to pay percentage rent during the requisite period, and then purports to terminate the lease on that basis.

What these three situations have in common is that by not resisting the temptation to continue accepting rent from the tenant in the face of an existing default by the tenant entitling the landlord to terminate the lease, the landlord has unintentionally forfeited its termination right.

The courts have repeatedly held that by accepting rent that becomes payable after a notice of default has been given to a tenant, the landlord will have irretrievably lost its ability to terminate the lease as a result of the particular default. Furthermore, this same result will occur if the landlord, being aware of the default, does anything that has the effect of confirming the existence of the lease and recognizes the relationship of landlord and tenant as still continuing. While acceptance of rent is the most obvious example of affirmation of the lease, simple acts such as sending out a year-end tax notice or a notice of estimated operating costs for the upcoming year or a request for contribution to an upcoming advertising campaign will be construed as affirming the continued existence of the lease. In large landlord organizations, where the department dealing with tenant lease billings is usually separate from the leasing and operations groups, the failure of the "left hand" to communicate with the "right hand" may spell disaster for the landlord. In the case of *Central Estates*

(Belgravia) v. Woolgar (No. 2),[1] the landlord served notice on the tenant claiming forfeiture of the lease due to default and then circulated a memo to its employees informing them of the forfeiture of the lease and instructing them not to demand or accept rent from the tenant. Unfortunately, the memo did not reach the desk of a low level clerk of the landlord and, unaware of the tenant's breach and the decision to terminate the lease, the clerk demanded rent which the tenant paid. The court held that the landlord had waived its right to forfeit the lease.

It is apparent from the foregoing that the landlord's intentions with respect to the continuation or affirmation of the lease are irrelevant. The courts have repeatedly held that is immaterial whether or not the landlord intended to waive the forfeiture and whether or not the tenant knew at the time of paying the rent that the landlord had the intention of forfeiting the lease. In short, the landlord's intention, and the tenant's knowledge of such intention, is irrelevant. The waiver results when the landlord accepts rent with knowledge of the default.

In an effort to circumvent the waiver problem, many leases contain a "non-waiver" clause, whereby the landlord and the tenant both agree that any overlooking by one party of the other party's default will not constitute a waiver of any rights or remedies with respect to the particular default. Some versions of this clause also state that any subsequent acceptance of rent by the landlord will not be considered to be a waiver of a preceding breach by the tenant, regardless of the landlord's knowledge of the breach. Recent case law has shown that "non-waiver" clauses will be ineffective and will not apply where the landlord has actually accepted rent that is payable after giving notice of a prior default. The acceptance of rent results in the landlord losing its right to terminate the lease for the prior default. In *R. v. Paulson,*[2] the court held that the landlord had waived its right of forfeiture by accepting rent, even though the landlord and the tenant understood that the landlord's acceptance of the rent was on a conditional basis and the lease contained a provision stating that any waiver had to be in writing.

The landlord must therefore decide whether to affirm or terminate the lease before accepting the rent. It cannot nullify the waiver by relying on a "non-waiver" clause or by stating that its acceptance of the rent is on a "without prejudice" basis to its right to terminate. However, the fact that the landlord is prevented from terminating the lease does not preclude it from exercising its other remedies under the lease, such as suing for breach.

A breach of covenant to pay rent is not a continuing breach. If rent remains unpaid for January, and the tenant defaults again in February, a landlord can accept the rent for January and still terminate for February. If the landlord has sent out a default notice but wants to accept rental payments subsequently offered, the landlord should apply the rent received in partial or full payment of any outstanding rent due for the period prior to the issuance of the notice. If the landlord indicates

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[1] [1972] 3 All E.R. 610 (C.A.)

[2] (1920), 54 D.L.R. 331 (P.C.)

that the money has been so applied, the landlord will have retained its right to terminate the lease for the subsequent default. The foregoing should be considered in the context of general rules of appropriation as follows.

The application of rental payments may be controlled by a direction from the tenant or the contract or custom of the parties. However, in the absence of any direction from the tenant or agreement of the parties as to the application of a payment, the landlord may ordinarily apply the payment to whichever claim it wishes. Payments made by a tenant to its landlord on account of rent in the absence of any direction by the tenant or any agreement of the parties generally may and, according to some authorities, will be applied to the extinguishment of the rents first accrued.[3] In order to ensure freedom in allocating rent as it sees fit without interference by a tenant who seeks to direct or allocate it otherwise, the lease should contain an "application of money" clause whereby the landlord may, (1) apply money received from or due to the tenant against money due and payable under the lease, and (2) the landlord may impute any payment made by or on behalf of the tenant towards the payment of any amount due and owing by the tenant at the date of such payment regardless of any designation or imputation by the tenant. This type of clause should be effective in allowing a landlord to apply any current payment received from a tenant against the oldest rental arrears. It may also enhance a landlord's ability to recover rent arrears where the tenant subsequently becomes bankrupt.

In summary, landlords should be cautioned against the unintended result that may arise from accepting rent that is offered by a tenant who is in default or in otherwise acting in some way which confirms the continued existence of the lease while the tenant is in default.

Your advice to the landlords encountering any of the three situations referred to in the first paragraph above is simple, if somewhat unusual: "Hope and pray for another default."

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[3] 52 Corpus Juris Secundum, p. 530; Malva Enterprises Inc. v. Rosgate Holdings Ltd., 14 O.R. (3d) 481 at 492 (C.A.)