

June 7, 2023

## **INDEMNIFIER BEWARE!**

A properly drafted indemnity agreement can be a powerful tool in a landlord's arsenal. All the more so since a recent Ontario court decision held that a landlord had no duty to mitigate its claim against an indemnifier under an indemnity agreement.

### **Indemnity Agreements and Mitigation**

Indemnity agreements are used to backstop a tenant's obligations under a lease. Their purpose is to help the landlord to be kept whole if the tenant defaults under the lease. There was a time when landlords used guarantee agreements for the same purpose; however, courts did not always uphold a guarantor's liability (such as in the case of a tenant bankruptcy). Eventually, landlords found a way to "bulletproof the backstop", by casting the guarantor's obligation as a primary obligation—an indemnity—independent of the tenant's lease obligations. Courts accepted this recharacterization and began enforcing indemnity agreements in circumstances where previously they had not.

The efficacy of indemnity agreements should not be underestimated. If the indemnity language is drawn correctly, a landlord's duty to mitigate its damages can be obviated.

This was exemplified in *Parc Downsview Park Inc. v. Penguin Properties Inc.* ("Penguin Properties"), a 2018 decision. In that case, the landlord claimed unpaid rent to the end of the term against an indemnifier. (The landlord had re-leased only a portion of the premises.) The indemnifier argued that the landlord had not reasonably mitigated its losses and was therefore barred from claiming future amounts of rent. The Ontario Court of Appeal found that on a strict reading of the indemnity agreement, the landlord was under no duty to mitigate its damages against the indemnifier. Consequently, the indemnifier was liable for all past and future losses incurred by the landlord.

### **The March 15, 2023, Ontario Superior Court Decision**

#### **Facts**

In 2017, FCP (BOPC) Ltd. ("Landlord") and Callian Capital Partners ("Tenant") entered into a lease for office space in First Canadian Place, Toronto. The Tenant's obligations were supported by two indemnity agreements signed, in the first instance, by Callian Capital Private Wealth Management Inc., and in the second by Cerieco Canada Corp (jointly and severally, the "Indemnifier"). The Tenant defaulted on its obligation to pay rent. The Landlord terminated the lease and later obtained judgment against the Tenant and the Indemnifier for \$478,170.90, reflecting unpaid rent, interest, and costs up to the date of the judgment. These funds were garnished and held by the sheriff (the "Garnishment Funds"). The judgment permitted the Landlord to return to Court to seek damages against the Tenant and the Indemnifier (jointly and severally), for the rent and other amounts over the remaining term.

Approximately one year later, the Landlord re-let the premises. A total of \$505,954.32 in unpaid rent had accrued between the date of the judgment and the commencement date of the new tenant's lease. The new lease rent was so significantly higher than under the old lease that, had the new tenant remained in the premises until the end of the original term, the Landlord would have suffered no loss whatsoever.

The Landlord asked the Court to order the release (by the sheriff to the Landlord) of the Garnishment Funds, as well as an order for payment of the rent under the old lease from the date of the judgment to the commencement date of the new lease.

The Indemnifier argued that the Landlord had mitigated its damages by entering into the new lease at an increased rent rate. The Indemnifier requested the Court to order a credit of the increased rent against the \$505,954.32, arguing that this was consistent with the Landlord's duty to mitigate. Conceivably, this could have reduced the Landlord's claim to zero.

## The Decision

Relying on Penguin Properties, the Court held that the indemnity agreements were separate contractual obligations “entirely independent of the Tenant’s obligation to pay rent under the lease”. In coming to this conclusion, the Court performed a strict reading of the indemnity agreements, which described the Indemnifier’s obligations as “absolute and unconditional...and the obligations of the [Indemnifier] shall not be released, discharged, mitigated, impaired, or affected” by a re-letting of the premises.

The Court held that the Indemnifier was liable for the full amount of rent from the date of the original judgment to the commencement date of the new lease.

## Duty to Mitigate vs. Double Recovery

Interestingly, the Court ordered the Landlord to provide the Indemnifier with annual reconciliations showing the difference between the rent collected from the new tenant and the amount payable under the old lease, and further directed that any excess be reimbursed to the Indemnifier annually.

At first glance, this part of the order seems to fly in the face of the Court’s decision that the Landlord had no duty to mitigate. However, it must be remembered that the purpose of an indemnity agreement is to ensure that the landlord is made whole, not to put the landlord in a better position. The higher rent collected from the new tenant essentially earned the Indemnifier a credit, to the extent of any amounts collected in excess of what was owed by the Indemnifier. A landlord will never be entitled to a windfall.

## Takeaway

While a landlord has a general duty to mitigate its claim for loss of future rent against a tenant, this duty may not extend to claims under an indemnity agreement. The claim under an indemnity agreement is usually different because it is not a claim for damages (which the law always requires a plaintiff to make reasonable efforts to mitigate). A properly drafted indemnity agreement may therefore be a very potent remedy for a landlord. Indemnifiers wishing to limit their liability must pay careful attention to the terms of the indemnity agreements they sign.

## ANNOUNCEMENT

Daoust Vukovich LLP is pleased to welcome **SHIVAN MICOO** to the firm as an Associate Lawyer in the firm’s leasing team. Shivan has worked in Canada’s real estate industry for his entire career. Prior to joining DV, Shivan was in-house counsel at Canada’s largest housing provider, and later at a major property management and development company in the Greater Toronto Area. Shivan is a graduate of the University of Windsor and was called to the Ontario Bar in 2017. Shivan can be reached at 416-304-9119 ([smicoo@dv-law.com](mailto:smicoo@dv-law.com)).

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