

## Commercial Real Estate

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### How to Terminate a Lease Without Getting Burned

Landlords often find themselves dealing with a tenant who is chronically in default of its obligations under its lease, most often as a result of their failing to pay rent when due. At some point the landlord decides that it has had enough and wants to get rid of the tenant. It looks at the lease, sees that it has a right to terminate the lease if the tenant is in default, gives the tenant whatever notice may be required under the lease and then proceeds to terminate the lease when the tenant fails to cure the default. No problem, right? Well, not necessarily.

A landlord's conduct after it becomes aware of its tenant's breach may result in the landlord inadvertently waiving its right to terminate the lease. If the landlord proceeds to terminate the lease after having waived its right to do so, it exposes itself to a potentially significant claim for damages from the tenant for having wrongfully terminated the lease and interfered with the tenant's business.

#### Is There a Continuing Relationship?

The leading case on landlord waiver in Ontario is the 1993 decision of the Ontario Court of Appeal in *Malva Enterprises Inc. v Rosgate Holdings Ltd.* In that case, Malva (the tenant) sued Rosgate (the landlord) for a number of things, including failing to complete the construction of the premises. Malva withheld rent as a result of the alleged defaults. Rosgate then counterclaimed against Malva for arrears of rent up to the date of judgment. In December 1992, Rosgate obtained a judgment for rental arrears to the end of November 1992. While Malva did not pay the arrears, it did pay the rent for December 1992 and for January 1993 with a cheque with the notation that the funds were for December/January rent.

Rosgate accepted the payments and notified Malva that it would terminate the lease unless the arrears were paid. Malva then applied for an order declaring that Rosgate had waived its right to terminate by virtue of having counter-claimed for the rent arrears and having accepted the January rent. The Court held that the lease was in effect and that Rosgate had waived its right to terminate. Rosgate appealed and lost.

The Court of Appeal held that:

- (a) a breach of covenant to pay rent is not a continuing breach and if a landlord waives its right to terminate for a failure to pay, the right cannot be revived;
- (b) by counterclaiming for the arrears of rent up to the

date of judgment and by accepting the January rent, the landlord was seen as affirming the continuation of the landlord and tenant relationship, thereby waiving the landlord's right to terminate the lease;

- (c) despite Rosgate's argument that it was entitled to apply the payment of the January rent on account of the earliest of the arrears, the notation on the cheque that the cheque was for the January rent prevailed.

The Court of Appeal also affirmed previous decisions that held that when a landlord becomes aware of a default by a tenant entitling the landlord to terminate the lease, the landlord will lose the right to terminate the lease by doing anything that appears to recognize a continuing landlord/tenant relationship.

The Malva decision was followed by the Ontario Superior Court in the 2002 decision, *Fitkid (York) Inc. v. 1277633 Ontario Ltd.* In Fitkid, the tenant was in arrears of rent and the landlord delivered a notice of default on account of those arrears. The landlord later got into negotiations with the tenant over roof repairs, accepted a late payment of rent, issued a new demand for rental arrears and threatened collection proceedings. The landlord then terminated the lease for non-payment of the arrears and the tenant sued for damages for wrongful termination of the lease.

The Court looked at the landlord's conduct after delivering the notice of default and determined that the landlord was continuing to treat the tenant as if the lease was still in operation. As a result, the Court held that the landlord had waived its right to terminate the lease for the arrears of rent specified in the notice of default. It is important to note that the Court arrived at this decision even though the lease contained a typical non-waiver clause which stated that nothing the landlord does (including accepting rent after a default by the tenant) would constitute a waiver of any its

rights. As a result, it appears that waiver clauses are virtually meaningless.

In addition to *Fitkud*, other cases have followed the lead in the *Malva* decision and found landlords to have waived their rights to terminate by accepting a payment on account of rent; by making a demand for the payment of rent; by commencing or threatening an action to recover the rent; by instructing the tenant to make repairs to the premises; and by discussing lease renewal.

### Landlords May Just Have to Wait

So what is a landlord to do when faced with a defaulting tenant? It has to decide very quickly if it wishes to terminate the lease and, if it does, be sure to do nothing inconsistent with that decision. If the lease requires the landlord to give notice of a default to the tenant and an opportunity to cure the default before the landlord can terminate, the landlord must ensure that the notice makes it clear that the failure to comply will entitle the landlord to terminate the lease. The landlord must communicate its decision to terminate to all of its personnel who have dealings with the tenant – including any property management firm that it uses and its personnel – and ensure that they do nothing inconsistent

with that decision that could be interpreted by the courts as affirming the continuance of the lease.

This will mean having to turn down a partial payment on account of the arrears and payments for the current rent – which many landlords will find difficult since ultimately they want to recover the monies owing to them by their tenants. While a landlord could try to have the tenant sign an acknowledgement that the landlord's acceptance of the payment does not waive the landlord's right to terminate and that the landlord may still terminate for the past arrears, it will likely be difficult to get a tenant to sign such an acknowledgment and, even if it did, there is no guarantee that the court would give effect to it.

At the end of the day, if a landlord wants to ensure that a tenant will not succeed with a claim for damages against the landlord for wrongful termination, then it simply cannot accept rent or do anything else that suggests the lease continues once it gives a notice of default or the right to terminate arises. If, after terminating the lease, the landlord wants to recover its damages (primarily any arrears of rent at the time of the termination and the value of the rent for the remainder of the term of the lease), the landlord will have to sue the tenant.

**Murray Box** has extensive experience drafting, negotiating and managing conflicts related to commercial leases.



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