HERE I GO AGAIN – OPTIONS TO RENEW AND EXTEND

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Introduction

In recent years the case law on options to renew and extend has proliferated, with recent judicial decisions making new law on issues which were once thought to be relatively settled. For example, recent case law from the Ontario Court of Appeal suggests that more options will be considered enforceable, rather than mere “agreements to agree”, and many appeal courts have taken different approaches to the remedies available for those who fail to exercise an option strictly according to its terms. This paper reviews the drafting, interpretation, and exercise of options in the context of recent Canadian developments.

1. The legal distinction between renewal and extension options

This paper uses the terms “renewal” and “extension” interchangeably, but these are two distinct and separate rights.

Where the parties agree to “extend the term” the existing contractual relationship is continued uninterrupted. In contrast, when the parties “renew the lease” this has the effect of creating a new lease because there is an instant between the end of the original term and the commencement of the renewal term when no lease is in effect. This distinction has some important ramifications.

First, under an extension the landlord can terminate the lease for a breach that predates the extension term; whereas in a renewal, the landlord cannot rely on any defaults prior to the commencement of the renewal term. Second, unless there is language to the contrary, an extension term does not release a previous tenant. However, since a renewal terminates the original lease and creates a new one, in principle, the renewing tenant is only liable for the obligations under the new lease.

In Québec, this distinction also exists. But a renewal of the term of the lease does not always automatically constitute a new lease, depending on the form it takes. If the renewal is set forth under an option to renew, and if such option sets out all of the terms and conditions applicable during the renewed term and nothing remains to be negotiated between the parties, then it will, under Quebec law, have the effect of extending the lease. If, however, in such an option to renew it is indicated that the parties will have to negotiate one of the essential elements of the lease (such as the rent rate), then such option to renew will be considered as an offer to conclude a new lease and such new lease will constitute a new contract.

2. Drafting tips from a Landlord's and Tenant's perspective including pre-conditions to exercise

When negotiating the inclusion of a renewal or extension option in a commercial lease, the manner in which such a provision is drafted is of paramount importance. The exact wording and phrasing of any

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1 Taken from Lisa A. Borsook & Aaron Kempl, with the assistance of Mireille Cloutier, “Recent Developments in Renewal and Extension Clauses in Leases”, 2014 ICSC Law Conference.

2 Taken from Daniel Weiner, “Be Careful How You Ask For What You Wish For: Drafting Preconditions For Lease Renewal and Extension Provisions”
condition precedent in such a provision must be clear, precise and demonstrative of the intent of the parties. Landlords must keep in mind that the inclusion or exclusion of a time related caveat to a condition precedent, or a limit on the nature or extent of the condition precedent, will each have a significant impact on the tenant’s ability to exercise an option to renew or extend, and will alter the manner in which a court will interpret such a provision. On the flip side, tenants should always negotiate for reasonable qualifiers on the nature of a default, such as “material”, “continuing” or “at the time of exercising”, and otherwise limit any pre-condition that spans the term of the lease. The following is an examination of how courts have interpreted certain phrases used in options.

(a) “Duly and Regularly”

In *Sparkhall v. Watson* the Ontario High Court concluded that the term “duly and regularly” in a renewal option meant that rent was to be paid in fixed intervals according to the rules established by the parties in the lease, which the court clarified as meaning “punctually, at the due date”. In applying this strict and narrow interpretation of the condition precedent, the court noted that the tenant’s breach was not a case of occasional, inadvertent or trivial default, but was a complete disregard of the purpose of meaning of the words set out in the renewal provision.

(b) “Not in Default During the Initial Term”

In *1290079 Ontario Inc. v. Beltsos* the Court of Appeal for Ontario affirmed that a right to renew in effect so long as the tenant “is not during the initial Term in default under any of the provisions or covenants of this lease” means that if there is a “subsisting breach” which has yet to be resolved, the option cannot be exercised. The Court reaffirmed the notion that a momentary or historical breach which has been cured at the time that a tenant seeks to exercise a right to renew does not constitute grounds upon which a landlord can refuse the right. If the claim had been resolved at the time the option was exercised, the default would fall within the category of a “spent breach”, as discussed in greater detail below, and would not preclude the tenant from its right to renew.

(c) “Material Default”

In the case of *1556724 Ontario Inc. v. Bogart Corp.* the tenant’s renewal right was contingent on the tenant being in good standing and having “not been in material default under the lease” was interpreted by the Ontario Superior Court to exclude the doctrine of “spent breach” (which will be discussed in further detail below). The Court found that the tenant’s previous breaches constituted “material breaches” under the terms of the lease, and therefore did not grant the tenant the right to exercise the renewal option. Despite the fact that the tenant had cured all defaults prior to exercising the renewal option, the failure to comply with the condition precedent precluded the tenant from relying on the renewal provision. The Court based its decision on the facts of the case and did not provide a method for determining what type of conduct would constitute a material breach. However, it is clear that the Court will scrutinize a tenant’s conduct closely and will consider a wide range of actions when making a determination with respect to a default under the terms of a lease.

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3. **How to draft an enforceable option**

In order for an option to renew or extend to be enforceable as opposed to being a mere “agreement to agree”, which is unenforceable at law, there are two required elements:

(a) a formula or reference standard to fix the new rent in the event that a dollar amount is not set out, e.g. “market rent” or “fair market rent”; and

(b) procedural machinery to determine the new rent in the event that the parties do not agree (i.e. an ADR process).

**(a) Formula/Reference Standard**

The formula or reference standard should specify the valuation date for the rent determination, whether it is for a restricted or unrestricted use (e.g. “market rent for a financial institution” vs. “market rent”), and any geographic restrictions (e.g. the plaza/complex, within a particular radius of the subject location, within a specified city). Sometimes the reference standard includes a “floor” e.g. not less than the rent for the prior term.

The valuation date and the terms of the valuation are critical and should be specified in the lease clause as part of the formula or reference standard. The valuation date could matter in a rapidly changing market or where the renewal notice is permitted to be served very far in advance of the commencement of the renewal term. The terms of the valuation should indicate whether it is the premises in the condition at the time of the original demise, or with the improvements made by the tenant or landlord during the last term. If all the improvements would otherwise revert to the Landlord at the end of the lease term, there is an argument that they should be included in the valuation. The language used in the Lease clause will determine whether the standard is objective (e.g. “fair market rent”, “fair market value”, “market value” or “market rent”) or subjective (e.g. “fair value”, “rent”, “worth”).

In *Mapleview-Veterans Drive Investments Inc. v. Papa Kerollus VI Inc.* ("Mapleview"), the Court of Appeal for Ontario affirmed the lower court's holding that “then current rate” was a sufficiently certain reference standard for the renewal rent and did not constitute an “agreement to agree,” because it was the functional equivalent of saying the rental rate would be at the “then market value” or the “then prevailing market rate.”

**(b) The procedural machinery**

Although the option at issue in *Mapleview* did not provide for arbitration or specify procedural machinery to determine the “then current rate”, the Court of Appeal held that there was nothing which prevented the parties from submitting the matter to arbitration or the courts if negotiations proved

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7 2016 ONCA 93 [Mapleview].

unsuccessful. There is limited authority for the point that the court can supply the mechanism to determine the new rent,\(^9\) and none was cited by the Court. *Mapleview* is now clear authority for this point.

4. **Meaning of “fair market rent”\(^10\)**

   There is contrasting case law on whether a calculation of “fair market rent” should be calculated based on any restrictions on the use of the premises, or whether the highest and best use of the premises should be used. Recent case law from the British Columbia Court of Appeal holds that a calculation based on “highest and best use” will not be implied into a lease.\(^11\)

   There is also contrasting case law on whether the value of leasehold improvements will be included in the calculation of “fair market value”. More recent case law from the British Columbia Court of Appeal indicates that the word “market” in the phrase “fair market rent” precluded the exclusion of the value of the tenant’s improvements in calculating the renewal rent. Accordingly, the renewal rent should be determined on the basis of the rent the premises would attract if exposed to the market with the leasehold improvements.\(^12\)

5. **How to properly exercise your option**

   (a) **Follow the terms of the option**

   The first step to properly exercising the option is to ensure that the mechanics for exercising the option outlined in the option are satisfied in terms of when to exercise the option, and how to properly give notice of exercise of the option. Where no date is specified by the lease in which an option must be exercised, it may be exercised at any time before or after the lease expires, so long as the tenant remains in the possession of the premises with the consent of the landlord.\(^13\) The landlord is entitled to put the tenant to an election as to whether or not it exercises the right to renew.\(^14\)

   (b) **Unequivocal exercise\(^15\)**

   It is well established that the exercise of an extension or renewal must be “clear, explicit, unambiguous and unequivocal”. Two recent cases provide practical illustrations of how the wording of a notice purporting to exercise an extension or renewal needs to be drafted very carefully.

   In *441 Main Inc. v. Silver Pawn Pictures Inc.*\(^16\) the Manitoba Court of Appeal held that a notice purporting to exercise an option to renew was properly a counteroffer and therefore not an effective exercise of the option. The lease contained an option to renew for a period of three or five years, to be exercised in writing by the tenant. During the tenancy, the tenant continually asserted that it had a right to

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\(^9\) For example, see *Dagny Development Corp. v. Ocean Fisheries Ltd.*, 1991 Canlii 528 (BCSC).
\(^10\) For more information, see Lloyd F. Cornett, “Renewals and Extensions of Term” in *Shopping Centre Leases, Second Edition*, Harvey M. Haber (eds.) (Aurora: Canada Law Book, 2008).
\(^11\) *Pacific West Systems Supply Ltd. v BC Rail Partnership*, 2004 BCCA 247.
\(^12\) *Fire Productions Ltd. v Kauro*, [2007] 1 WWR 605 (BCCA).
\(^13\) *Guardian Realty Co. of Canada v John Stark & Co.*, [1922] 64 SCR 207, 1922 CarswellOnt 133 at paras 22-23.
\(^14\) *Guardian*, ibid at para 17.
\(^15\) Taken from Lisa A. Borsook & Aaron Kempf, with the assistance of Mireille Cloutier, “Recent Developments in Renewal and Extension Clauses in Leases”, 2014 ICSC Law Conference.
\(^16\) 2013 MBCA 70.
purchase the building. Correspondence between the parties demonstrated that the landlord did not accept the tenant’s position. The tenant informed the landlord in writing that it wished to renew the lease for five years. However, the notice then went on to state that the tenant anticipated purchasing the building as promised before the expiry of the extension term. The landlord responded that this was not a valid exercise of the option as no agreement existed to sell the building to the tenant. The landlord further notified the tenant that it expected the tenant to vacate the premises at the end of the term. The tenant continued to assert that it provided valid notice and remained in the premises beyond the expiry of the term.

The Manitoba Court of Appeal held that by inserting the second sentence into the notice, the tenant was attempting to establish a link between the lease and the purchase right which made the notice a counter offer and, as a result, it did not have the effect of exercising the option under the lease.

Similarly, in Money Mart Canada Inc. v. Austrocan Investments Inc.\(^\text{17}\) the British Columbia Supreme Court found that a purported exercise of an option was not unequivocal and therefore not an effective exercise. The tenant sent a letter stating that it was “writing to formally exercise our five (5) year option to renew the Lease from July 1, 2009 to June 30, 2014.” The letter then went on to request several amendments, including a rent reduction, a new termination right and a change in the use clause. The letter concluded by stating “if you are in agreement with this proposal, please initial Page 1, sign the acknowledgment below and return both pages to our office...” The landlord did not sign and the parties were unable to agree to the changes. The landlord delivered a notice of termination a few months after the expiry of the term.

The court commented that if the letter had stopped after the first section it would likely have held that the option was properly exercised. However, by going on to request amendments to the lease, the right to renew was not being sought “on the same terms and conditions” as those in the original lease, which was a requirement for exercising the option. Thus, the landlord validly terminated the lease, which had converted to a month-to-month tenancy.

\(\text{(c) Strict compliance with the terms of the option}\)^\(^\text{18}\)

It is well established law that when a renewal option contains a no default precondition the onus will be on the tenant to show that it has complied with the condition. If there is a no default precondition that is satisfied at the time that the tenant exercises its option but if there is a default following the exercise of the option, the landlord can refuse to allow the tenant to renew. Again, as this is an option solely benefitting the tenant, the tenant must comply with the agreed upon preconditions. As explained in 120 Adelaide Leaseholds Inc. v. Oxford Properties Canada Ltd.,\(^\text{19}\) renewal options will be interpreted against the tenant since equity “plays no part in the interpretation of the option”.\(^\text{20}\) Courts will expect tenants with valuable renewal or extension options to take all necessary steps (including compliance with

\(\text{\textsuperscript{17} 2012 BCSC 1634.}\)

\(\text{\textsuperscript{18} Taken from Lisa A. Borsook & Aaron Kempf, with the assistance of Mireille Cloutier, “Recent Developments in Renewal and Extension Clauses in Leases”, 2014 ICSC Law Conference; Julie Robbins and Sheldon Disenhouse “It’s Time to End this Dance – Dealing with Defaulting Tenants who have Extension or Renewal Rights”}\)

\(\text{\textsuperscript{19} 28 ACWS (3d) 950, [1991] OJ No. 1507, (Ont Ct J) [Adelaide Leaseholds], aff’d 44 ACWS (3d) 359, [1993] OJ No. 2801, (Ont CA).}\)

\(\text{\textsuperscript{20} Ibid at para 14.}\)
any necessary preconditions) to preserve the right. Accordingly, if there is a no default precondition that is not satisfied, then the renewal option is prima facie lost.

In determining whether or not there has been a default, unless the precondition states otherwise, it is not necessary at law that notice of the default have been given to the tenant. However, as will be discussed below, there may be waiver arguments and/or equitable relief available to the tenant if a landlord continues to accept rent in the face of a default by a tenant and then waits until the tenant exercises its option before advising the tenant that it is not entitled to do so because of a default.

(d) **Doctrine of spent breach and subsisting breaches**

While there are defaults which warrant the loss of an option, not all defaults are equal and the loss of a renewal option may not always be a reasonable or fair consequence for a default (even if the option contains a no default precondition), especially if the default has been cured or remedied by the time the tenant exercises its option. The doctrine of “spent breaches” addresses this concern. The English Court of Appeal described the reasoning behind the doctrine in the case *Bass Holdings Ltd. v. Morton Music Ltd.*:

First, it must be accepted that absolute and precise compliance by the tenant with every single covenant throughout the period of the lease prior to the operative date is virtually impossible of attainment. If this were required as a condition precedent, then the option would in practice be worthless or merely at the mercy of the landlord. Therefore the parties cannot have intended that the absence of spent breaches should be a condition precedent. Secondly, however, it is natural and sensible that the landlord should require the tenant not to be in breach of any covenant on the operative date and that all outstanding claims for breach of covenant should have been previously satisfied, so that the lease is then effectively clear. The proviso is therefore to be construed as intended to apply to subsisting breaches, with the result that the relevant condition precedent is the absence of any subsisting breach.

The recent decision of the Court of Appeal for Ontario in *1290079 Ontario Inc. v. Beltsos*, confirmed the doctrine of spent breaches, but went on to hold that a breach is not spent and is still subsisting if there is an existing cause of action in respect of the breach at the time the option is exercised (even though, in this case, neither the landlord nor the tenant were aware of the cause of action at the time the tenant exercised its option). The facts were a little unique and unusual (and a case of really unfortunate timing). During the term the tenant had failed to ensure that the required insurance was obtained pursuant to the terms of the lease. After a number of requests from the landlord, the tenant remedied the default and was in compliance with the insurance obligations when it exercised its renewal option on June 17, 2009. The landlord initially refused to accept the exercise of the option because of the various defaults by the tenant during the term (even though there were no defaults at that time). When the tenant commenced proceedings seeking a declaration that it had validly exercised its option, a third

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21 Taken from Julie Robbins and Sheldon Disenhouse “It’s Time to End this Dance – Dealing with Defaulting Tenants who have Extension or Renewal Rights”

22 [1987] 2 All ER 1001, [1987] 3 WLR 543 (UK CA) [*Bass Holdings*].

23 Ibid at 518.

24 2011 ONCA 334, 280 OAC 312 [*Beltsos*], aff’g 2010 ONSC 4967, 192 ACWS (3d) 1357.
party commenced a claim against both the landlord and the tenant in connection with a slip and fall at the property the day before the tenant had remedied the insurance defaults. The Court of Appeal reviewed the cases discussing the doctrine of spent breaches and stated:

These authorities stand for the proposition that an historical breach of a lease covenant, once remedied, will not entitle a landlord to refuse an otherwise valid option to renew the lease. In the case law, this has become known as the doctrine of ‘spent breach’.  

However, in this case, there was an existing cause of action at the time the option was exercised which meant that the default was subsisting. The Court of Appeal explained the decision in the following words.

"An historical breach, once remedied, will not preclude a tenant from exercising an option to renew so long as the lease is “effectively clear” on the renewal date. If a landlord has a subsisting cause of action against the tenant that is rooted in the breach, the lease is not effectively clear.”

Another limitation imposed on the doctrine of spent breaches by the Ontario Court of Appeal is that it will not apply if there are subsisting defaults even though the tenant has not received notice of those defaults. In 1383421 Ontario Inc. v. Ole Miss Place Inc., the Court of Appeal noted that the option was conditional upon the tenant not being in default and since the renewal option did not qualify this by saying that it had to be a default for which notice had been delivered, it disagreed with the lower court that notice had to first be delivered:

Thus, with respect, the Landlord’s actions (or lack thereof) in respect of notice and removal are not relevant to the question of whether the Tenant was in breach. The applications judge erred in relying on the Landlord’s failure to give notice when determining whether the Tenant had validly renewed the lease.

Landlords can also avoid the doctrine of spent breaches with clear drafting. In Cardillo Entertainment Corp. v. PCM Sheridan Inc., the no default precondition specified that the renewal option would not apply if the tenant was in material or chronic default and defined “chronic” default as being three or more defaults. There was no dispute that the tenant had been in chronic default. The tenant argued that the defaults were spent breaches, but the Court determined that this was not relevant since the lease stated that the option would be extinguished if there were chronic defaults:

In my view, the doctrine of spent breach does not save the option provision in this case. Regardless of whether the Plaintiff is, at the time it seeks to exercise the option, in good standing under the lease, nothing can erase the Plaintiff’s abysmal record of defaults. The defaults have

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28 Ibid, at para 52.
29 2011 ONSC 4426.
been chronic and continuous and, in accordance with the clear wording of section 18.01(a), the option to extend is extinguished.  

6. **Exceptions to strict enforcement rules**

(a) **Waiver and estoppel by conduct**

Tenants that cannot prove compliance with the no default precondition to an extension option may try to argue that the landlord waived its rights to insist on strict performance of the precondition and/or is estopped from insisting on such performance. The burden of proving such waiver or estoppel will be on the tenant and, based on the case law, waiver or estoppel is not easy to establish. In order to establish waiver, it “would require evidence that they had full knowledge of their rights and unequivocally and consciously intended to abandon them.”

With respect to estoppel, there is essentially a two part test: first, a promise not to insist on strict performance of the lease must have been made that would alter the legal relationship between the parties, and secondly, the promise must have been acted upon. The Court in *1323677 Alberta v. 334154 Alberta Ltd.*, also described “estoppel by convention” which is based on a shared assumption rather than a promise. The test for estoppel by convention, as stated in *1323677 Alberta* is:

1. a manifest representation by statement or conduct creating a mutual assumption;
2. reliance on the shared assumption that resulted in a change of legal position;
3. it must be unjust or unfair to allow one of the parties to resile or depart from the common assumption; in this regard, the party seeking to establish estoppel has to prove that detriment will be suffered if the other party is allowed to resile from the assumption since there has been a change from the presumed position.

In *1323677 Alberta*, the Court held that if it was wrong that there was no default by the tenant, that it would have found that the landlord was estopped from insisting on the no default precondition because the parties had a shared assumption of what the occupancy costs were and that the tenant relied on the landlord’s silence in not advising it otherwise.

Continued acceptance of late payments of rent while a tenant is in default will not always constitute waiver or estoppel (although doing so will likely result in waiver of the right to terminate for late payment). In *Ole Miss Place*, the tenant argued that since the landlord continued to accept rent after the tenant exercised its option, the landlord could not refuse to recognize the option. The Court distinguished between acceptance of rent when a landlord is exercising a forfeiture/termination right versus satisfaction of a no default precondition for a renewal option. In the Court’s view, the issue was whether or not the tenant had properly exercised its option, and the Court quickly rejected the tenant’s

30 *Ibid*, at para 47.
31 Taken from Julie Robbins and Sheldon Disenhouse “It’s Time to End this Dance – Dealing with Defaulting Tenants who have Extension or Renewal Rights”
32 2014 ABQB 486.
33 *Ibid*.
34 *Ibid*, at para 78.
35 *Ibid*.
36 1383421 Ontario Inc. v. Ole Miss Place Inc. (2003), 67 OR (3d) 161 at paras 60 and 72, 231 DLR (4th) 193, (Ont CA) [*Ole Miss Place Ont CA*].
argument that acceptance of rent would bar the landlord from refusing to accept the exercise of the renewal option.

The argument that acceptance of rent amounts to a waiver of the Tenant’s breaches, such that the Landlord is barred from raising the breach in the context of a lease renewal, is not legally sound. In Jardine, the Privy Council stated that acceptance of rent payments with knowledge of a breach waives the right to forfeiture; it does not waive the covenant or condition itself. The court stated, at p. 289: “In the case of a forfeiture clause, acceptance of rent after a known breach of a covenant or condition is not waiver of the covenant or condition or some part thereof, but waiver of the right to forfeit which has arisen the breach”.37

However, there are some cases described below which contain exceptions to this waiver argument. Continuing to negotiate a renewal or extension past the date by which the tenant’s option notice had to be sent will also not be considered waiver or estoppel with respect to compliance with a no default precondition.

In determining whether or not a landlord has waived its rights to insist upon strict compliance of a no default precondition, the fairness and reasonableness of the landlord’s conduct will likely influence the Court as well as the overall equities of the situation. The decisions where tenants have successfully argued waiver or estoppel usually have facts where there is some questionable conduct on the part of the landlord. For example, in Firkin Pubs Metro Inc. v. Flatiron Equities Ltd,38 the landlord and tenant negotiated renewal rents for approximately a year following receipt of the tenant’s renewal notice before the landlord claimed that the tenant was not entitled to exercise the option. While the Court found that there had been no default by the tenant it did go on to consider the waiver argument and noted that the landlord had “conducted itself in such a way as to lead Firkin [the tenant] to believe that it had effectively exercised its option”.39 As a result of the landlord’s conduct the tenant had not looked for alternate premises. The landlord was estopped from arguing that the option had not been properly exercised. The Court noted that the landlord “cannot remain silent and then later insist that the situation of which it had known all along was a default under the lease.”40

In Wanke Developments Ltd. v. Silver Tree Ventures Ltd,41 the landlord had taken “an informal, casual and loose approach to the observance and implementation” of the lease throughout the term and did not raise concerns with the tenant’s compliance until after the tenant had exercised its option. The British Columbia Superior Court was critical of the landlord’s sudden insistence on strict compliance with the lease and how it coincided with rising rents in the market which the landlord could collect from a new tenant. The Court held that the landlord waived its right to insist on strict compliance with the lease. In finding that the landlord waived its rights, the Court stated:

To the extent of any unlawful breaches of the Lease and its renewal by Silver Tree [the tenant], I find that Wanke [the landlord] with full

37 Ibid, at para 77.
38 2011 ONSC 5262.
knowledge of such by acceptance of rent duly paid by Silver Tree throughout the entire term and by Wanke’s general course of conduct a clear intention on its part not to rely on the breaches and waived strict compliance with the lease covenants in relation to such as a condition precedent to Silver Tree’s exercise of the right of renewal. Further, Wanke by its conduct is estopped from alleging a breach of covenant as a grounds of denying renewal.\footnote{42}

In \textit{H.Y. Louie Co. v. Whistler Noodle House Ltd.},\footnote{43} the British Columbia Superior Court held that the landlord waived its rights to insist on the no default precondition when it had unconditionally accepted late rent payments. However, the Court appeared to be influenced by the fact that the tenant would suffer great hardship by losing the renewal option (loss of its business and investment and lost jobs for its employees) and the landlord had no immediate plans for the premises. In addition, at the time that the tenant exercised the option it was not in default (while the Court did not refer to the spent breaches doctrine, the reasoning would follow that it should apply if the tenant had cured all defaults by the time it exercised the option).

In \textit{B & R Holdings Ltd. v. Western Grocers Ltd.},\footnote{44} the tenant’s monthly rental payments were short by three cents (other than one month each year) but the landlord never demanded the shortfall nor made any request for it until after the tenant exercised its option. The Saskatchewan Court of Queen’s Bench noted that the shortfall was “inadvertent and trivial”.\footnote{45} By continuing to accept rent despite the shortfall, the landlord was found to have waived strict compliance with the no default precondition. The Court also found that the landlord was estopped from insisting on the no default precondition since by its conduct it had represented to the tenant that strict compliance was not necessary and the tenant acted on this representation/promise. Again, the Court did not look favourably upon the landlord waiting until the option had been exercised to raise this issue:

\begin{quote}
It appears the landlord waited until the expiration of the term to raise the concerns leading the tenant to believe there were no breaches. The conduct of the landlord brought about an estoppel. Accordingly, the landlord is estopped from alleging a breach of the covenant to pay rent as a reason for denying renewal of the lease.\footnote{46}
\end{quote}

With respect to rental defaults, if a landlord has accepted a method of payment other than that required by the lease, it may be assuming the potential risks associated with the new form of payment. While \textit{Sail Labrador Ltd. v. Navimar Corp.},\footnote{47} is not a commercial leasing case, it is relevant on this point. In that case, the optionee was required under the agreement to make payments by bank transfer and/or certified cheque. However, the owner did not insist on compliance with this and accepted post-dated cheques at the beginning of each season. As a result, the Court held that the owner could not insist on strict compliance with the payment provisions in the agreement and stated:

\begin{quote}
\footnote{42} \textit{Ibid}, at para 25.  
\footnote{43} 2002 BCSC 1120.  
\footnote{44} 1982 CarswellSask 514.  
\footnote{45} \textit{Ibid}, at para 21.  
\footnote{46} \textit{Ibid}, at para 42.  
\end{quote}
The modified method of payment accepted by the parties involved a risk of delay in clearing the cheques…The respondent must bear the consequences of this risk equally with the appellant because it materialized as a result of their mutually accepted alteration of the strict terms of the agreement.48

Applying this reasoning in the commercial leasing context, if a landlord were to accept a form of payment other than that required under the lease, it may not be able to argue there is a default if there is a delay in payment due to the new form of payment.

While the waiver and estoppel decisions are very fact-based and will often turn on what the Court believes to be the equitable result, there are steps a landlord can take to limit its potential exposure to waiver and estoppel claims by a tenant. For example, if a landlord is not terminating a defaulting tenant (or exercising any other remedies available to it in respect of a default by a tenant) it would still be prudent for the landlord to advise the tenant, in writing, if it is intending to insist upon strict compliance with a no default precondition to an extension option. Staying silent and waiting until a tenant has exercised the option to advise that the tenant has not satisfied the no default precondition will not be looked upon favourably by a Court. While continuing to accept rent from a defaulting tenant will likely result in waiver of forfeiture rights, it is not necessarily waiver of a no default precondition to an extension option so long as the landlord by its conduct has not promised or represented to the tenant that it will not be insisting on compliance with the precondition. For tenants that are unsuccessful at arguing waiver or estoppel, there may still be instances where it can obtain equitable relief from the Court.

(b) Relief from forfeiture49

Whether a Court has jurisdiction to grant relief from forfeiture where there has been a failure to comply with the conditions precedent necessary to exercise an option is contested and varies on jurisdiction. Some Courts have reasoned that while relief from forfeiture could cure loss of the lease following defaults, it is not available to cure non-compliance in exercising a lease option, as there is a difference between the loss of a right and a failure to acquire a right.50 This has been explained by the Manitoba Court of Queen’s Bench as follows:

Forfeiture implies the loss of a right that at the time is capable of being exercised, whereas a condition precedent implies the existence of a condition that must be fulfilled before an agreement is created or becomes effective.51

Manitoba courts have held that they do not have the jurisdiction to award this relief, as have courts in Alberta.52 In contrast, Ontario courts have recently affirmed that they have the jurisdiction to

48 Ibid, at para 85.
49 Taken from Barbara Grossman and Aoife Quinn, “New developments in the law of options,” Legal Alert, July 2016; Julie Robbins and Sheldon Disenhouse “It’s Time to End this Dance – Dealing with Defaulting Tenants who have Extension or Renewal Rights”.
52 Styles v Alberta Investment Management Corporation, 2017 ABCA 1.
award relief from forfeiture, although the test for this and the situations in which it will be applied remain in flux.

The Ontario Superior Court has jurisdiction to award relief from forfeiture where there has been a failure to comply with a precondition to exercise of the option to renew, however the court’s jurisdiction is “narrow” or “limited.”53 Generally, when granting relief from forfeiture a Court will examine the following factors: (i) the conduct of the applicant, (ii) the gravity of the breach, and (iii) the disparity between the value of the property forfeited and the damage caused by the breach.54

A necessary condition in granting relief from forfeiture of an option to renew is that the claimant made diligent efforts to comply with the terms of the agreement which are unavailing through no default of its own.55 Courts have found fault on the part of an optionee where: the optionee made no effort to determine whether the required insurance was obtained under the lease and instead relied on its subtenant to procure the insurance;56 and the optionee was not diligent in performing its covenant or responsive to correcting it.57 Courts have found no fault on the part of an optionee where the optionee was missing the relevant pages of the lease which outlined the relevant covenant,58 or where the tenant paid the incorrect amount of occupancy costs, because the occupancy costs were calculated incorrectly by the landlord.59 This appears to capture the first step of the general test for relief from forfeiture, which is concerned with whether the applicant acted reasonably, which is assessed by looking at the entirety of the applicant’s conduct, which considers the nature of the breach, the cause of the breach, and what the applicant did about the breach.60

Secondly, the gravity of the breach is assessed by weighing the nature of the breach of the covenant itself and the impact of that breach on the contractual rights of the other party.61 The Court of Appeal for Ontario in Kozel v. Personal Insurance Co. (“Kozel”)62 offered the example of a situation where “the forfeiture provision operated as a means of securing the payment required under a lease, the fact that the breaching party had paid all the amounts owing could obviate the need to resort to forfeiture and support a claim for relief.”63

Finally, the disparity between the value of the property forfeited and the damage caused by the breach must be considered. The case law indicates that where the opportunity lost to the optionee is great, but the damages suffered by the landlord are very small, this will weigh towards a finding of forfeiture.64

53 Mapleview, supra note 7 at para 55.
56 1290079 Ontario Inc. v Beltsos, 2010 ONSC 4967, aff’d 2011 ONCA 334 at para 57.
57 Ibid, at para 32
58 7867786 Canada Ltd. v. Ugarrit Inc., 2015 ONSC 4276 at para 19.
59 1323677 Alberta Ltd. v. 334154 Alberta Ltd., 2014 ABQB 486 at paras 62, 74.
60 Kozel, supra note 52 at para 61.
62 2014 ONCA 130.
63 Kozel, supra note 52 at para 67.
64 1284468 Ontario Ltd v. 1121157 Ontario Ltd., 2002 CarswellOnt 5610 (Sup Ct) at para 204.
The recent case law in Ontario has focused on the prerequisite of whether “the tenant has made diligent efforts to comply with the terms of the lease which are unavailing through no default of his or her own,” citing the 1992 Court of Appeal decision Ross v. T Eaton Co (“Ross”).

In Mapleview, the Court of Appeal for Ontario strictly applied the test found in Ross, and denied relief from forfeiture on that basis. The tenant had admitted rent arrears of $251.92, and it was paying its monthly additional rent in the old amount rather than the increased amount requested by the landlord whose calculations the tenant disputed. The Court of Appeal held that if the tenant wished to preserve its right to exercise the option, it could have paid the small amount of admitted arrears and the disputed higher additional rent amount, and then sought a correcting adjustment in the year end reconciliation.

In Velout Catering v Bernardo, the Ontario Superior Court took a more relaxed interpretation of the test than was taken in Mapleview. There the tenant failed to exercise its option to renew in time because it was under a mistaken belief, perpetuated by the Landlord’s misstatements that the lease actually ended a year later. The landlord and tenant had an informal relationship as they were friendly towards each other, and they had some informal discussions regarding renewal. When the tenant realized its’ mistake in regards to the lease term, it attempted to engage in discussions with the landlord regarding renewal but the landlord refused to respond until after the deadline to exercise the option. Notably, the tenant’s attempt to arrange a meeting with the landlord regarding renewal and its decision to wait to hear back from the landlord regarding that meeting was “reasonable and diligent given the long, trusting and informal relationship that they [the landlord and tenant] shared.” These facts, coupled with the investment the tenant had made in the property, justified the application of relief from forfeiture.

In 2405416 Ontario Ltd. v. 2405490 Ontario Inc., another recent case regarding options from the Ontario Superior Court, yet another test for relief from forfeiture was applied, this time in relation to an option to purchase. There, the Court held that the governing factors as to whether relief from forfeiture was to be applied were:

all the circumstances including: the history of the relationship; breaches of other covenants of the lease by the tenant; the gravity of the breaches; the tenant’s conduct or misconduct; its good faith or bad faith or want of clean hands; whether the object of the right of forfeiture in the lease was essentially to secure the payment of money; and the disparity or disproportion between the value of the property forfeited and the damage caused by the breach.

The Court would have applied relief from forfeiture had it held that the tenant was in default under the lease. On the facts, the Court held that the relationship between the parties was good until the Tenant

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66 Mapleview, supra note 7.
67 Ross, supra note 65.
68 2016 ONSC 7281.
69 Ibid, at para 36.
70 2016 ONSC 3893.
71 Ibid, at para 60.
decided to exercise the option to purchase, “the alleged failure to seek formal written consent to the leasehold improvements was clearly mitigated by the fact that [the Landlord] was aware of and approved of them,” and it would have been unreasonable for the Landlord to withhold consent.\(^\text{72}\)

In British Columbia, the current leading case on this point is the Court of Appeal’s decision in *Clark Auto Body Ltd. v. Integra Custom Collision Ltd.*\(^\text{73}\) Unlike the above noted cases from Ontario, Clark Auto Body held that relief from forfeiture is not available to a tenant that failed to satisfy a no default precondition in a renewal option. In this case, the tenant was in rental default at the time it exercised its renewal option (approximately $1,200.00 was owing in respect of sales taxes payable on rent). The landlord had previously advised the tenant of the amounts owing and the tenant paid a portion of what was owing. Following receipt of the renewal notice, the landlord delivered a notice of default and then a notice of termination (at which point the tenant paid the outstanding amount). The Court of Appeal had to determine whether the tenant was entitled to relief from forfeiture in order to preserve its renewal option.

The Court reviewed the case law discussing the no default precondition for extension options and held that equitable relief should not be granted in these situations. Justice Kirkpatrick for the Court stated:

> In my opinion, it is essential to distinguish between the court’s equitable jurisdiction to grant relief from forfeiture for the non-observance of covenants in an existing lease and from the failure to comply with conditions precedent to the exercise of an option to renew a lease. In the former, equity recognizes that a tenant may be permitted to cure its default and be relieved from forfeiture to allow it to retain the balance of the term of the lease. In the latter, there is no compulsion on the tenant to exercise the renewal option, but if it does so, the tenant must comply with the conditions precedent. If the tenant fails to comply, it does not suffer a penalty or forfeiture of an existing tenancy. Equity will not intervene.\(^\text{74}\)

7. **Whether a landlord is subject to a duty of good faith and if so, how it applies**\(^\text{75}\)

In *Bhasin v Hrynew* ("Bhasin"),\(^\text{76}\) the Court clarified the role of good faith in contractual relations under Canadian common law. Writing on behalf of a unanimous Court, Cromwell J. recognized good faith contractual performance as an “organizing principle” of the common law of contract, which “underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance.”\(^\text{77}\)

The Court clarified that good faith as an organizing principle signifies “that parties generally must perform their contractual duties honestly and reasonably and not capriciously and arbitrarily.”\(^\text{78}\) Courts

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\(^{72}\) Ibid, at para 62.  
\(^{73}\) 2007 BCCA 24.  
\(^{74}\) Ibid, at para 30.  
\(^{75}\) Taken from Lisa Borsook and Aaron Kempf, “Update on Good Faith in Commercial Leasing”  
\(^{76}\) 2014 SCC 71.  
\(^{77}\) Ibid at para 33.  
\(^{78}\) Ibid at para 63.
may use the organizing principle to develop the law, provided that doing so is consistent with the fundamentals of contract law and in particular, a party’s ability to pursue its own self-interest. More specifically, the duty to act honestly in the performance of contractual obligations requires that parties “not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.”

In light of the Court’s decision in *Bhasin*, it appears that while parties are still entitled to pursue their own self-interest throughout the performance of a contract, they must also ensure that they conduct themselves in an honest manner, while having regard to the legitimate interests of their co-contracting party. Although the concept of good faith does not necessarily trump the established doctrines of contractual interpretation, it is an important organizing principle that informs the application of such doctrines in particular fact situations.

Since the release of *Bhasin*, there have been very few leasing cases that discuss the duty of good faith in the performance stage of a contract. *Bhasin* certainly imposes an independent duty of good faith in the performance of a party’s obligations under a lease, but the scope and specific parameters of that duty have yet to be fully determined. However, subsequent non-leasing cases have given further meaning to the duty of honesty and good faith in the context of contractual performance.

(a) **Pre-*Bhasin* case law dealing with options**

In *Rinaldo Hair Stylist Limited v. bcIMC Realty Corporation* the tenant entered into a lease for a ten year term with an option to renew for two additional five year terms. Written notice of the tenant's intention to renew was required to be delivered by May 31, 2007. The tenant did not deliver the notice but was negotiating with the landlord's agent (Bentall Retail Services, “Bentall”) about the renewal and a possible expansion. Despite ongoing discussions, the parties could not come to an agreement and the landlord gave the tenant a notice of termination on March 20, 2008. The tenant argued that the landlord had waived the strict written notice requirement by continuing to negotiate, through its agent, terms of the renewal after the notice date has passed.

The landlord argued that letters provided by its agent to the tenant during the course of the negotiations made it clear that there was no such waiver. Bentall reminded the tenant in February 2006 of the requirement to provide written notice to exercise its option. Bentall also made it clear after May 31, 2007 that the landlord was considering other tenants but was willing to negotiate if the tenant was interested in staying. For its part, Bentall argued that it owed no duty to the tenant as there was no privity of contract and there is no independent, stand-alone duty to act reasonably and in good faith.

The Ontario Court of Appeal upheld the lower court’s decision granting the landlord’s motion for summary judgment. The court held that there was no conduct on the part of the landlord that could reasonably have led the tenant to believe that the landlord was waiving compliance with the requirement for written notice. Any negotiations between the parties after May 31, 2007 were negotiations outside of any restrictions imposed by the lease. The landlord was entitled to pursue its own interests and neither it nor Bentall owned the tenant a duty of good faith.

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79 Ibid at paras 66, 70.
80 Ibid at para 73.
81 Taken from Lisa A. Borsook & Aaron Kempf, with the assistance of Mireille Cloutier, “Recent Developments in Renewal and Extension Clauses in Leases”, 2014 ICSC Law Conference.
82 2013 ONCA 38.
In Québec, the parties must act reasonably and in good faith as stated under Sections 6, 7 and 1375 of the Civil Code of Québec. The parties cannot contract out of those Sections.

(b) **Bhasin as applied to options**\(^83\)

Since *Bhasin*, there have been no cases concerning extension or renewal options which have engaged in an in-depth application of the duty of good faith. However, a few cases have clearly demonstrated that, going forward, the grant and exercise of such options will need to be considered through the lens of good faith.

In the Ontario Superior Court decision of *Data & Scientific Inc. v Oracle Corp.*\(^84\), Oracle had sole discretion to accept the renewal of the contract with Data & Scientific. The parties had renewed the contract several times over a 20 year period. However, in 2014 after inviting Data & Scientific to submit an application to renew, Oracle subsequently decided not to renew the contract. Among other things, Data & Scientific claimed that Oracle was obligated to exercise its discretionary renewal power reasonably. While the court did not rule on the actual merits of the claim (because the case came before the court through a motion to strike – which was dismissed), the court rejected Oracle’s argument that the duty to exercise discretionary contractual powers reasonably did not apply to contract renewal situations.

In *Osteria Da Luca Inc v. 1850546 Ontario Inc.*,\(^85\) Kane J. of the Ontario Superior Court of Justice expressly referenced Bhasin and the duty of honesty in contractual performance. The court also individually enumerated the elements of the principle of good faith that were established in Bhasin, including the requirements to: “(i) act honestly; (ii) in good faith; (iii) to have regard for the legitimate interest of the contracting partner; [and] (iv) not seek to undermine those interests in bad faith through lies or knowingly misleading the other party about matters directly related to the performance of the contract.”\(^86\) Some of these criteria are relatively simple to apply. For example, misleading a tenant about the enforceability of their renewal clause will always be a risky proposition. However, as discussed in the next section, other aspects are less clear.

In the recent British Columbia case of *International Sausage House Ltd. v. Hammer Estate*,\(^87\) the purchaser began negotiations to purchase the property from the landlord, and the deadline for renewing the tenant’s lease passed with no written notice given to the landlord. The tenant subsequently brought an action for breach of contract and declarations surrounding the lease, claiming that it had validly renewed the lease and exercised a right of first refusal before the lease expired.

Among other things, the tenant argued that the purchaser and landlord wrongfully refused to honour the tenant’s right of first refusal on the basis that their conduct fell short of the principle of good faith.\(^88\) The Court held that the purchaser did not breach its duty to exercise its contractual discretion honestly and in good faith. This was because the purchaser had an objective basis for its decisions, and “was not motivated by a desire to improve its position by obtaining the best possible price from the

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\(^83\) Taken from Lisa Borsook and Aaron Kempf, “Update on Good Faith in Commercial Leasing”.

\(^84\) 2015 ONSC 4178.

\(^85\) 2015 ONSC 5606.

\(^86\) *Ibid* at para 51.

\(^87\) 2015 BCSC 1155.

\(^88\) *Ibid* at para 175, citing *Bhasin*, supra note 2 at para 65.
vendor. It was not trying to avoid "leaving money on the table".89 Therefore, the purchaser and the landlord did not breach their duty to act honestly and in good faith.

(c) Bhasin going forward90

The future application of the principle of good faith may alter the current practice of leasing law. If all rights under a lease are now subject to an obligation of good faith, what will that look like in practice?

To take one example, suppose an option to extend the term of a lease states that the rent will be agreed upon by the parties, but does not provide for recourse to arbitration should an agreement fail to materialize. Could an arbitration provision be implied into a lease on the basis of good faith? Even in the wake of Bhasin, to date, no court has suggested that good faith mandates implying substantive rights into a contract. Indeed, in one of the few leasing cases citing Bhasin, the court commented that Bhasin does not disentitle a party to a lease from relying on an express term negotiated by the parties.91 This flows from the idea, noted in Bhasin, that a party pursuing its own self-interest is not necessarily acting contrary to good faith and that such behaviour may in fact be encouraged on the basis of economic efficiency.92 Thus, if an option is drafted as an agreement to agree, the parties should be permitted to rely on that structure, assuming that one of the parties did not mislead or deceive the other into agreeing to it.

However, suppose that an option is drafted as an agreement to agree and the landlord insists on rent of $60 per square foot, while the tenant honestly believes that fair market rent is $30 per square foot. If the tenant can support its position with evidence, could it argue that the landlord is not acting in good faith and have a court impose either a duty to negotiate in good faith or a mechanism to determine the rent? As noted previously, while no court has suggested that there is a general duty to negotiate in good faith, courts have implied such a duty in certain situations. For example, where an option requires the parties to negotiate the rent, it has been held that this requires the landlord to negotiate in good faith and not to withhold agreement unreasonably.93

That being said, even where a duty to negotiate in good faith has been found to exist, it has not resulted in the implication of new substantive rights, such as a right to match an offer being read into a contract.94 Imposing an arbitration mechanism into a lease agreement, along with the various obligations necessitated by it, would certainly constitute a new substantive right. Given the direction provided by the Court with respect to the scope of good faith, and the Court’s concern with respecting the terms of a contract, it is unlikely (but not inconceivable) that a court would take such an action on the basis of good faith. However, as reflected in the Mapleview decision referred to earlier,95 courts may get there through other means.

In Mapleview,96 the Court held that even though a renewal clause in a lease did not provide for arbitration, if the parties were unable to agree on the “current rates” for the renewal rent, this did not

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89 Ibid at para 177.
90 Taken from Lisa Borsook and Aaron Kempf, “Update on Good Faith in Commercial Leasing”.
92 Bhasin supra note 2 at para 70.
94 SCM Insurance Services v. Medisys Corporate Health LP, 2014 ONSC 2632.
95 Supra note 7.
96 Ibid.
render the option unenforceable as the parties could resort to “judicial or other binding means” as the lease did not explicitly preclude this option.97

As a result, in a situation where an extension or renewal option takes the form of an agreement to agree, the organizing principle of good faith and the duty of honest contractual performance likely require the parties to take positions that are honestly held and supported by credible evidence. In some circumstances, depending on the wording of the lease and the conduct of the parties, a court may even find there is a duty to negotiate in good faith. However, it seems unlikely that a court would use good faith as a means of imposing a rent determination mechanism, such as an arbitration clause, into an option where the parties expressly chose to draft it as an agreement to agree. However, based on Mapleview, at least in the context of a rent determination mechanism in a renewal or extension term, parties may not need to rely on good faith to achieve such a right. It remains to be seen whether good faith arguments will be relied upon to try to obtain other substantive rights going forward.