

Ongoing Liability of Landlords and Tenants Post-Assignment

ICSC LAW CONFERENCE APRIL 20, 2017

Stephen Posen^{*}

INTRODUCTION

A lease establishes a long term relationship between a Landlord and Tenant. Such a relationship establishes both “privity of estate” and “privity of contract”.

As situations change, either the Landlord or Tenant may wish to end such relationship by assigning its interest to a third party. In doing so, the exiting party will want to minimize or eliminate its ongoing liability pursuant to its obligations under the lease. Although the same practical result may follow regardless of the method of transfer used by the parties, the form of the assignment will affect the relationship and legal rights among the Landlord, Tenant and Transferee.

When a lease is assigned by Landlord or Tenant, generally speaking, the parties intend to pass along to the Assignee the benefits and obligations of the Assignor contained in the lease. Without further steps, such intention may not be successfully realized in absence of a further agreement. The Assignee is obliged to perform only those obligations that run with the land, i.e. those obligations established by privity of estate. The Assignee, not being a party to the original lease, is not bound by those obligations that do not run with the land as those obligations are based on privity of contract.¹ Additionally, the Assignee will benefit from all the covenants that run with the land but not those that do not. To repeat, it will benefit from obligations established by privity of estate but not privity of contract.

^{*} Partner, Minden Gross LLP with special thanks to Ladi Onayemi, Student-at-Law, Minden Gross LLP for his assistance in preparing this paper

¹ The terms *touch and concern the land*, *run with the land* and *have reference to the subject matter of the lease* will be used interchangeably in this paper.

A covenant is deemed to run with the land when it “*affects the mode of using or enjoying the leased property or when it deals with the landlord-tenant relationship*”.²

Obligations that run with the land are “privity of estate”, and the Assignee is bound by such obligations.

Williams & Rhodes gives examples of express covenants which touch or concern the land and that run with the land and are established by privity of estate. Such examples include the covenant to pay rent, to render services in the nature of rent, to pay taxes, to repair and leave in repair, to repair and renew fixtures, to erect a building on the leased land, not to erect a building in a prescribed area, to pay for improvements made by the Tenant, to conduct business properly, to use the premises for a restricted purpose, to allow access by the Landlord to supply utilities, to provide janitorial services, to heat, to insure, and many other covenants.”³

In contrast, there are covenants that are personal to the Landlord or Tenant, as well as others that relate to matters that do not directly affect the land or the lease. As these covenants do not run with the land, they are only binding on the original parties to a lease but not an Assignee. Obligations that do not run with the land are based on “privity of contract” and in the absence of another agreement, will not bind an Assignee.

Obligations of a party that are based only on privity of contract, and do not run with the land, may be enforced by an Assignee in the same manner as the assignment of any commercial contract. So, in the result, an Assignee would not be bound by obligations of the Assignor that do not run with the land but will have the benefit of the obligations of the other party that do not run with the land. Examples of covenants that do not run with the land and based on privity of contract (and not estate) are set forth later in this paper.

² Haber, Harvey M, “*Assignment, Subletting and Change of Control in a Commercial Lease*” Page 4 (Aurora, Ont: Canada Law Book, 2002)

³ Williams & Rhodes, Canadian Law of Landlord and Tenant, 6th ed. by C.A.W. Bentley, J.H. McNair and M.J. Butkus (Toronto: Carswell, 1988).

Rather a curious exercise to distinguish such rights and obligations that run with the land and those that do not, but that is the wondrous world of legalese.

The proper manner to ensure that all obligations are passed on to Assignee, even though they may not run with the land, is to have the Assignee enter into an assumption agreement with the other party pursuant to which the obligations based only on a privity of contract, as well as the obligations based on privity of estate, become a matter of contract between the Assignee and the other party to the lease and not just those obligations based on privity of estate.

LANDLORD TRANSFERS

A lease of premises within a commercial or industrial property will usually contain many obligations, some more onerous than others, on the part of the Landlord. It follows that, if the property were transferred by the Landlord, assigning the lease or leases to the Purchaser, the original Landlord would, generally, expect to be released of its obligations to each of the Tenants under the leases.

While it is true that, upon assigning its interest in a lease, the Purchaser will become obligated to perform each covenant made by the original Landlord that touches and concerns, or runs with, the land, the original Landlord will not be released of its obligations unless it is so provided in the lease or another agreement with the Tenant. For that reason, most leases of non-residential premises provide that the Landlord, upon transferring the lease to a Purchaser, is released of its obligations thereunder, at least to the extent that those obligations are assumed by the Purchaser.

Original Landlord Rights and Obligations

After an assignment, the original Landlord will still have certain rights and obligations in relation to the lease and the leased premises. One right the original Landlord will retain is the right to sue the Tenant for any amounts payable under the lease prior to the assignment. However, the Landlord does not retain the right to re-enter or terminate the lease after the assignment. Obviously, therefore, it would be prudent for the Landlord to ensure that all amounts payable under the lease are paid in full up to the time of the assignment.

Transferee Landlord Rights and Obligations

The *Commercial Tenancies Act* outlines the rights and obligations of a Transferee/Landlord following an assignment. Section 4 of the *Act* states that when a Landlord assigns its interest in a lease the Transferee is able to benefit from remedies against the Tenant provided that the covenants of the Tenant were expressly contained in the lease agreement.

Section 7 of the *Act* provides that, after an assignment, a Tenant has the same remedies against the Transferee as it had against the original Landlord prior to the assignment. As shown in the *College Street* decision referred to below, the fact that the Tenant has rights and remedies against the Transferee does not mean that the original Landlord will be released from its obligations, as they may still be liable as a result of a breach by the Transferee.

The 1992 case of *Superior Acceptance Corp. v. 22 College Street Inc.*⁴ provides a clear example of the continuing obligations of an original Landlord after an assignment. Although a final lease was never signed, the Tenant began paying rent which was accepted

⁴ (1992), 25 R.P.R. (2d) 208 (Ont. Ct. (Gen. Div.)) [*College Street*]

by the Landlord. A fire subsequently damaged the building, but the drafts of the lease contained a fire clause stating that, if the premises were destroyed and could not be repaired within 180 days of the fire, the Landlord could terminate the lease. On the other hand, the drafts provided that, if the premises could be repaired within 180 days of the fire, the Landlord would be required to make the necessary repairs to the building, with the Tenant not being liable for rental payments during the 180-day repair period. The Tenant received a letter from the original Landlord with a certificate from an architect advising the Tenant that the Landlord would be rebuilding and, as a consequence, the Tenant would be held to its obligations as a Tenant under the fire clause in the lease agreement. In reliance on the letter and the architect's certificate, the Tenant obtained temporary premises for the repair period. The original Landlord then sold the building and the purchaser, being the Assignee of the Landlord, terminated the Tenant's lease based on a revised architect's certificate which stated that the premises could not be repaired within the 180 day period. The Tenant brought an action against the original Landlord, the Landlord's Assignee and a subsequent Transferee/Landlord, all of which were found liable.

The Court found that the original Landlord was liable to the Tenant for breach of its covenant of quiet enjoyment, notwithstanding the assignment. As noted above, an assignment does not affect the privity of contract between the original Landlord and the Tenant. The Transferee/Landlords, with actual notice of the lease, were bound by the lease and any related agreements by the original Landlord. This meant that the Transferee/Landlord was liable for breaching the Tenant's lease, which included provisions binding successors and assigns. Further, the Transferee was bound by Subsections 7 and 8 of the *Commercial Tenancies Act* which provide that an original Landlord's covenants will remain binding on the Transferee.

The following are examples of Landlord covenants that do not run with the land:

- The covenant to grant an option to purchase the lands.⁵
- The covenant to keep other properties (not the leased premises) in repair.⁶
- The covenant not to open a competitive enterprise within a specified radius from the leased premises.⁷
- The covenant to repay the security deposit.⁸
- A Transferee of the Landlord was found not liable to account for overpayments of additional rent as they are viewed as an obligation to repay that is no different from the obligation to return a deposit.⁹
- Tenant has no claim against the current Landlord for the return of a GST payment made to the former Landlord.¹⁰

Conclusion

From a Landlord's perspective, in order that on selling a property a Landlord has no further obligations to a Tenant, a Landlord should ensure that the lease contains a provision that, on such sale, the Landlord is released from its obligations under the lease. To protect itself, the Tenant should require that such release of the Landlord is predicated on the purchaser agreeing with the Tenant to assume all of the Landlord's obligations under the lease.

⁵ *Woodall v. Clifton*, [1905] 2 Ch. 257 (C.A.).

⁶ *Dewar v. Goodman*, [1909] A.C. 72 (H.L.); *Ricketts v. Enfield Churchwardens*, [1909] 1 Ch. 544.

⁷ *Thomas v. Hayward* (1869), L.R. 4 Ex. 311

⁸ *Re Dollar Land Corporation and Solomon* In *Re Dollar Land Corporation and Solomon*,⁸ Dollar Land Corp. was not liable to account for a security deposit previously paid by the tenant to the original landlord. This case concerned a residential tenancy, but followed in subsequent commercial tenancy decisions including, *Devon Estates Limited v. Royal Trust Co.* and *Canada Trustco Mortgage Co. v. Mundet Industries Ltd.*

⁹ *Devon Estates Limited v. Royal Trust Co.*, [1995] 2 W.W.R. 293 (Alberta Queen's Bench)

¹⁰ *Canada Trustco Mortgage Co. v. Mundet Industries Ltd.*, [1996] O.J. No. 3746 (Ontario Ct. (Gen. Div.))

TENANT TRANSFERS

An assignment of a lease creates privity of estate between the Assignee and the original Landlord, but not privity of contract. Consequently, after an assignment by the Tenant of its lease, a Landlord is able to enforce against the Assignee all of the covenants in a lease agreement which run with the land, but will not be able to enforce those covenants which do not.

Original Tenant Rights and Obligations

Absent a full and complete release (to be negotiated between the Landlord and Tenant), the original Tenant will be liable for all obligations under the lease based on privity of contract for the balance of the terms and for all amounts based on privity of estate accrued due up to the time of the assignment, but for which the Landlord has not yet rendered accounts, such as a year-end reconciliation of realty taxes, operating costs, or other forms of additional rent. Although, as mentioned above, the Landlord should ensure that all amounts payable under the lease are paid in full up to the time of the assignment.

Examples of Tenant covenants that do not run with the land include the covenant to pay a third party annually¹¹, the covenant to pay taxes imposed on another property¹², and the covenant to replace personal property¹³.

In order for a Landlord to be able to enforce against the original Tenant all of its obligations under the lease after an assignment, even those are based on privity of estate, leases should so provide.

¹¹ *Mayho v. Buckhurst* (1617), Co. Jac. 438

¹² *Gower v. Postmaster-General* (1887), 57 L.T. 527

¹³ *Gorton v. Gregory* (1862), 3 B & S 90, 122 E.R. 35

Transferee Tenant Rights and Obligations

Following an assignment, the primary liability under the lease is intended to be that of the Assignee. However, the Assignee will not be liable to perform the covenants which do not run with the land in the absence of an agreement between the Landlord and Assignee. To ensure that the Assignee will be liable for the performance of the obligations under the lease that do not run with the land, the Landlord should require, as a term of its granting of consent to an assignment, that the Assignee create privity of contract with the Landlord as well as of estate by contracting directly with the Landlord (by way of an assumption agreement) to be bound by and perform all of the obligations of the Tenant pursuant to the lease. Subject to the terms of such assumption agreement, an Assignee is not liable for obligations under the lease which accrued prior to the assignment.¹⁴

The following are examples of Tenant covenants that run with the land:

- A lease clause granting a Tenant, its employees and invitees the right to use parking in common with others entitled thereto was held to be a covenant running with the land.¹⁵
- An option to renew is an *in rem* covenant runs with the land and/or leasehold interest¹⁶
- The covenant to pay rent.¹⁷
- The covenant to pay taxes.¹⁸
- The covenant to repair.¹⁹
- The covenant to insure against fire.²⁰

¹⁴ *Emmett v. Quinn* (1881), 7 O.A.R. 306 (C.A.), at p. 321.

¹⁵ *Merger Restaurants v. D.M.E. Foods Ltd.* [1990] M.J. No. 319 (Man. C.A.) (QL).

¹⁶ *Supra* note 3. An option to renew the term is a covenant by the landlord to grant the tenant a further term and as such, is a covenant that touches or concerns the land. A covenant to renew binds both the Purchaser of the Landlord's interest and is available to the Tenant's Assignee, whether or not there is any express statement to that effect

¹⁷ *Williams v. Bosanquet* (1819), 1 Brod. & B. 238, 129 E.R. 714; *Parker v. Webb* (1963), 3 Salk. 5

¹⁸ *Mackinnon v. Crafts, Lee & Gallinger* (1917), 33 D.L.R. 684 (Alta. C.A.)

¹⁹ *Perry v. Bank of Upper Canada* (1866), 16 U.C.C.P. 404

- The covenant not to assign without the Landlord's consent.²¹
- The covenant to buy particular goods from only the Landlord.²²
- Covenants that do not run with the land.

Subsequent Assignments by Tenant

Significantly, it must be noted that the Assignee's obligations to perform the covenants which run with the land exist only so long as the Transferee holds the leasehold interest in the land.²³ If the Assignee further assigns the lease, the Landlord will have no rights against the original Assignee except in respect of those covenants which run with the land and which accrued during the period in which the Assignee held the leasehold interest.²⁴

An Assignee becomes liable under the lease for covenants of the Tenant which run with the land but not those that do not run with the land. As stated above, it is prudent for a Landlord, when consenting to an assignment, to require that the Assignee contract directly with the Landlord to assume all of the Tenant's obligations under the lease so that the Assignee becomes liable for those covenants not only that run with the land but including those covenants that do not run with the land.

It is to be noted, however, that if an Assignee further assigns the lease, it would at that point no longer be liable for covenants that run with the land or that do not run with land. Accordingly, when consenting to an assignment of a lease, a Landlord should require an assumption agreement from the Assignee to provide that the Assignee becomes liable for all covenants of the Tenant (including those that do and do not run with the land) for the balance of the term, even after a further assignment.

²⁰ *Douglass v. Murphy* (1858), 16 U.C.Q.B. 113

²¹ *Goldstein v. Sanders*, [1915] Ch. 549; *Cohen v. Popular Restaurants Ltd.*, [1917] 1 K.B. 480

²² *Rudd v. Manahan* (1913), 11 D.L.R. 37 (Alta. C.A.), aff'd 5 D.L.R. 565 (Alta. S.C.)

²³ *Moule v. Garrett* (1870), L.R. 5 Exch. 132; *Magill v. Young* (1853), 10 U.C.R. 301 (Q.B.).

²⁴ *Magill v. Young* (1853), 10 U.C.R. 301 (Q.B.).

Inadvertent Release of Original Tenant

In order for a Landlord to be able to deal with its tenants in a reasonable manner, a Landlord would want to manage its relationship with an Assignee of the Tenant on a routine basis. For example, an Assignee and Landlord may wish to make amendments to the lease, or the Assignee may wish to make alterations to the premises, which, based on the usual provisions of a lease, would require the approval of the Landlord.

The original Tenant, presumably having agreed that it would continue to be liable for all of its obligations pursuant to the lease for the balance of the term, assumes the role similar to that of surety or indemnifier; the Assignee would, at that point in time, be primarily liable for the obligations of the Tenant under the lease and the original Tenant would become secondarily liable in the same manner as would a guarantor or indemnifier.

An analogy can be drawn between the obligations of a guarantor of a debt and the original Tenant under a lease after the assignment of the lease. There is a considerable body of law which provides that, in certain circumstances, variations of the primary debt of a debtor which enlarge the obligations of the debtor and, consequently, the obligations of the guarantor because its position, in such circumstances, would be prejudiced. By analogy, the position of the original Tenant under a lease, bearing in mind the concept that the original Tenant should remain liable for all of the Tenant's obligations for the balance of the term of the lease, could be adversely affected by amendments to the lease or by Landlord consenting to substantial alterations or a further assignment to a party with a weak financial covenant.

Accordingly, the Landlord entering into an amending agreement with an Assignee or consenting to substantial alterations by the Assignee might, arguably, depending on the amendments or scope of alterations, constitute a substantial change to the obligations of the Assignee to the detriment of the original Tenant; in such circumstances, the original Tenant

might inadvertently be released from its obligations under the lease as a result of such amendments or alterations.

It is advisable, therefore, for a Landlord to provide in a lease or in a consent to an assignment of the lease that the original Tenant and all Assignees remain liable for all of the Tenant's obligations for the balance of the term and any renewals or extensions notwithstanding any such amendments or alterations. The original Tenant, on the other hand, should require that its obligations, notwithstanding any such amendments or alterations, would be limited to what the original Tenant's obligations would have been but for such amendments or alterations.

The general principal of the original Tenant becoming a surety, guarantor or indemnifier following an assignment of the lease was dealt with in the case of *Crystalline Investments Ltd. v. Domgroup Ltd.*²⁵, a case in the Supreme Court of Canada in 2004. In that case, an Assignee of the lease become insolvent and the lease was disclaimed in the Assignee's insolvency proceedings. The original Tenant sought to argue that, because the lease was disclaimed, the original Landlord was released from its obligations under the lease in the same manner as would have been a guarantor, relying upon the much discredited case of *Cummer-Yonge v. Fagot* which, finally, met its demise in the Crystalline case. However, but for such decision by the Supreme Court of Canada in Crystalline, the insolvency of an Assignee of the original Tenant might also have served as an inadvertent release of the original Tenant of its obligations under the lease.

ASSUMPTION AGREEMENT

²⁵ *Crystalline Investments Ltd. v. Domgroup Ltd.* [2004] 1 S.C.R. 60; 16 R.P.R. (4th) 1, 184; 235 D.L.R. (4th) 513; 70 O.R. (3d) 254)

As referred to above, the preferred method of ensuring that a Tenant remains liable for its obligations for the balance of the lease following an assignment of the lease, is to require the original Tenant and its Assignee to enter into an assumption agreement.

To begin, the original lease should provide that the original Tenant will remain liable for all of its obligations under the lease notwithstanding any assignments, alterations, amendments to the lease or disclaimer of the lease in any insolvency proceedings. Beyond that, the lease should also provide that the lease may not be assigned by the Tenant unless the Assignee enters into an assumption agreement to be liable for all of the Tenant's obligations under the lease, both those based on privity of estate and those based on privity of contract. Further, when the Landlord is called upon to consent to an assignment by the Tenant, the consent agreement should provide both that the original Tenant confirm its liability for all covenants of the Tenant under the lease for the balance of the term and any extensions and to have the Assignee covenant to the same effect.

It is equally appropriate for a Tenant to require that a purchaser or Transferee from the Landlord of the lease assume all of the obligations of the Landlord under the lease, failing which the Tenant should seek to ensure that the original Landlord is liable for all of the Landlord's covenants under the lease for the balance of the term.

One further thought is the position of a guarantor or indemnifier related to the Tenant's obligations under a lease. In the same manner as a guarantor would be released of its obligations under a guarantee in the event of a fundamental change to the original debts, similarly an indemnifier might argue that a Landlord's consent to assignment to a potentially weaker party than the original Tenant might also prejudice the Landlord's position as against the original indemnifier. Accordingly, the original indemnifier should be made a party to any assumption or consent agreement and confirm that it will remain liable for all of its

obligations under the indemnity agreement (being all of the obligations of the Tenant under the lease) for the balance of the term of the lease and any renewals or extension).

CONCLUSION

It can be seen from the ruminations contained in the paper above that there are many factors to be taken into account when dealing with the rights and obligations of the parties to a lease in the event of any assignment by Landlord or Tenant. Those factors should all be taken into account and appropriately dealt with by proper contractual arrangements among the parties, both in the lease and in any subsequent dealing with the lease.

#2770733 v6 | 4000007
3/30/2017 9:24:29 AM