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WHEN THE TENANT WANTS TO DUMP THE LEASE AND THE LANDLORD DOESN'T, "WHOSE PROBLEM IS IT?"

In Canadian common law jurisdictions, when the tenant defaults under a commercial lease, the landlord doesn't *have* to do anything. The landlord can simply insist that the lease remain alive, and demand that the tenant pay the rent as it comes due.

Landlord's Remedies

When a tenant breaches a commercial lease, a landlord has 4 options that were authoritatively set out by the Supreme Court of Canada in the landmark 1971 decision of *Highway Properties Ltd. v Kelly, Douglas and Co. Ltd.*

The 4 options are: (1) keep the lease alive and demand payment of rent when due; (2) terminate the lease and pursue a claim against the tenant for arrears; (3) re-enter the premises and sublease them on the tenant's behalf; and (4) terminate the lease and pursue a claim against the tenant for not only arrears, but also "damages" in the form of rent payable over what would have been the balance of the term.

Highway Properties added the 4th option on the basis that a commercial lease ought to be recognized as a commercial contract and not merely a conveyance of land. The Supreme Court ruled that it was not "sensible to pretend" that a lease was not also a contract, and that landlords should be allowed the "full armoury of remedies ordinarily available" to address a breach of contract.

Landlord's Claim for Damages

Whenever a landlord elects to terminate and sue for the rent remaining over the balance of the term, it is suing for "damages". Damages is a legal term that essentially means, the monetary equivalent of what the wronged party suffered when the wrong occurred. However, the wronged party can only recover damages to the extent that they could not have been avoided by taking reasonable steps available at the time. This limitation on recovery is often referred to as the "duty to mitigate".

Thus, if a landlord sues its tenant for damages, the landlord is required to demonstrate that it made reasonable efforts to mitigate them. In commercial leases this typically means that the landlord must make reasonable efforts to re-let the premises.

There is strong rationale for mitigation: it avoids waste and promotes economic efficiency.

Keeping the Lease Alive

Nevertheless, one of the 4 options for a landlord is to do nothing more than insist on performance. It may demand that the tenant pay the rent as it comes due, because the lease is still in place. This option is available due to the 'real estate' aspect of a lease. Just as a vendor of land need not reduce the price when the buyer no longer cares to purchase, the landlord need not accept less rent when the tenant no longer needs the space. The tenant might look for a subtenant to alleviate the ongoing rental burden, but the landlord is entitled to insist on getting what it bargained for: performance of the lease by full payment of the rent over the balance of the term. In this case, the landlord has no duty to mitigate. It need not attempt to re-let the space. This general rule has been affirmed repeatedly by Canadian common law courts.

Aphria

In a recent Ontario Superior Court of Justice decision, *The Canada Life Assurance Company et al. v. Aphria Inc.* ("*Aphria*"), the tenant challenged the idea that the landlord can do nothing. It asserted that the time had come to overrule the decision in *Highway Properties.* It asked the court to impose a duty to mitigate regardless of the remedy selected by the landlord when the tenant defaulted.

In *Aphria*, the tenant leased commercial office space in Toronto under a ten-year lease signed in 2018. By 2021, the tenant's business had changed course and the office space no longer fit into its business plans. The tenant advised the landlord that it no longer required the premises and proposed an early termination. The landlord rejected the tenant's proposal. The tenant then claimed to repudiate (i.e., terminate) the lease. It paid the landlord an additional three months' rent. The landlord notified the tenant that it rejected the tenant's purported termination, and that it was electing to keep the lease alive. The tenant's broker provided the landlord with leads for new potential tenants. The landlord did not follow-up on the leads. When the tenant ultimately stopped paying rent, the landlord sued the tenant.

The Court dealt with the primary issue of whether the landlord had a duty to mitigate when the tenant defaulted.

The landlord pointed to 50 years of jurisprudence based on *Highway Properties*, including subsequent appellate level decisions, confirming that it had no duty to mitigate. The tenant argued that the time had come to overrule those decisions, characterizing them as providing an "anomaly in contract law". The tenant argued that "in all other areas of commercial contract law, an innocent party to a repudiation is expected to take reasonable steps to mitigate or to avoid the losses associated with the breach".

In essence, the Court was being asked to shift the burden of the tenant's non-performance of the lease to the landlord, who refused to accept it and insisted that the tenant, not the landlord, own the problem of the undesirable lease.

In a careful and extensive decision, the Court rejected the tenant's position. While it expressed sympathy for the tenant's argument, it refused to depart from binding precedent, noting that the proposed change in the law would fundamentally alter the remedies available to a commercial landlord. In the Court's opinion, the change advanced by the tenant could have a "dramatic impact" on leases already made. The Court noted that lower courts follow the principles established by higher courts, to promote "consistency and predictability in the law".

As a sub-argument, that tenant maintained that its liability was capped at 2 years' worth of rent because the lease contained a provision stating that "notwithstanding anything in this Lease to the contrary, in no event shall Tenant be liable for … lost Annual Rent in excess of two (2) years of Annual Rent falling due immediately following the default". The Court held that, since this provision was embedded in a paragraph dealing with termination, it did not apply in circumstances where the landlord did not elect to terminate the lease.

Takeaway

There are good reasons to require parties to mitigate when they suffer losses under a contract. There are also good reasons to adhere to precedent case law, especially where an entire industry is predicated on the reliability of income flow created by a lease commitment. The competing reasons came head-to-head in *Aphria* and for now, *Highway Properties* remains the law of the land.

The decision in *Aphria* is under appeal by the tenant. Stay tuned.

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