



Daoust Vukovich Baker-Sigal Banka LLP
BARRISTERS & SOLICITORS

PERPETUITIES AND LEASES

By: J.E. Dennis Daoust
Return of the Six Minute Real Estate Lawyer
November 28, 2000

THE SIX MINUTE REAL ESTATE LAWYER PERPETUITIES AND LEASES

J.E. Dennis Daoust
DAOUST VUKOVICH BAKER-SIGAL BANKA LLP
November 30, 2000

When dealing with leases, the common law rule against perpetuities (the "Rule"), and the Perpetuities Act R.S.O. 1990, c.P.9. (the "Act") need to be considered. The purpose of the Rule is to preserve the alienability of property by limiting the period for which absolute vesting may be postponed. It is not a simple rule of construction but rather, a peremptory command of law. Its object is to defeat intention where that intention might result in too lengthy a restriction on the ability of a person to dispose of property. The Rule is applied remorselessly.¹

It is therefore important to ensure that in drafting rights pertaining to leases (just as with other interests in property) proper attention be paid to the Rule. Note that The Rule only applies to property and does not apply to contracts or personal contracts.²

The Rule

The Rule at common law may be stated as follows:

". . . every estate or interest must vest, if at all, not later than 21 years after the determination of some life in being at the time of the creation of such estate or interest that limits or is a relevant factor in limiting the period within which the estate or interest will vest."³

This Rule as so stated applies in Ontario only in respect of interests or estates in real or personal property created before September 6, 1966. After that date, the creation of interests in property is governed by the Rule as modified by the Act.

Under the Rule, at common law, the contingent interest must be capable of vesting within the period

¹See Waters, *Law of Trusts in Canada* (1974), p.261 and Gray, on *The Rule against Perpetuities* (4th ed. 1942) S.629

²*Weinblatt v. Kitchener*, [1966] 2.O.R. 740; affirmed [1969] S.C.R. 157 and *Tilbury Town Gas Co.v. Maple City Oil etc. Co.* [1915], 35 O.L.R. 186; affirmed 32 D.L.R. 771

³*Ferguson v. Ferguson* (1878) 39 U.C.Q.P. 232, reversed 1 O.A.R. 452; reversed on appeal to S.C.R. 497

limited by the Rule after the creation of the interest, and, if it is possible for an interest to vest after that time period then the Rule is breached and the creation of the interest is void. Subsequent events cannot make it valid. The effect of Sections 3 and 4 of the Act is that even if it is possible that the contingent interest will vest outside of the Perpetuity period it will not automatically be voided if it is capable of vesting within the Perpetuity period. (This is what is commonly referred to as the “wait and see” rule.) Pursuant to this rule, the interest is presumed to be valid until actual events establish that it will not vest within the relevant period.

Leases

For our purposes, Section 13 (a copy of which is attached as Appendix “1”) is, particularly important. Section 13 deals with options to acquire reversionary interests. It states that the Rule does not apply to an option to acquire for valuable consideration an interest reversionary on the term of a lease:

- “(a) if the option is exercisable only by the lessee or lessee’s successors in title and
- (b) if it ceases to be exercisable at or before the expiration of 1 year following the determination of the lease.”⁴

Under Subsection 13(2), the treatment of an agreement for a lease as it applies to a lease is the same as for a lease and “lessee” is construed accordingly.

Note that under Subsection 13(3), in the case of all other options to acquire for valuable consideration any interest in land the Perpetuity period is 21 years “and any such option that according to its terms is exercisable at a date more than 21 years from the date of its creation is void on the expiry of 21 years from the date of its creation as between the person by whom it was made and the person to whom or in whose favour it was made and all persons claiming through either or both of them, and no remedy lies for giving effect to it or making restitution for its lack of effect.

Options to Renew

Subsection 13(4) states that the Rule does not apply, nor do the provisions of Subsection 13(3) apply to options to renew a lease.

Easements

Section 14 of the Act (a copy of which is attached as Exhibit “2”), states that in the case of an easement, profit a prendre or other similar interest to which the Rule applies, the perpetuity period

⁴Section 13(1)

is 40 years from the time of creation of the easement etc. and the validity or invalidity of the easement etc so far as remoteness is concerned, is to be determined by actual events within the 40 year period. The easement etc. is void only for remoteness if, and to the extent that, it fails to acquire the characteristics of a present exercisable right in the servient land within the 40 year period.

What does all this mean to the leasing lawyer?

To determine the practical import of the Rule as modified by the Act it is useful first to refer to the following summary taken from Anger and Honsburger, Real Property.⁵ The summary is as follows:

- “1. A mere personal contract, unconnected with property, is not subject to the Rule.
2. A contract, connected with property, such as an option, is subject to the Rule and, in Canada, although not in England, is unenforceable as between the contracting parties and their successors if it exceeds the Perpetuity period.
3. An option in favour of a lessee to purchase the reversion is subject to the Rule.
4. An option to renew a lease even if perpetual, held by the lessee, is not subject to the Rule.
5. A right of first refusal, a right preemption and similar rights are not subject to the Rule.”

As was seen above, the Rule in point 3 that an option in a lessee to purchase the reversion is subject to the Rule has been reversed by the Act.

To fully appreciate the practical impact of the Rule, as modified by the Act, for leases, it is necessary to pay close attention to the wording of Section 13 of the Act.

(Note in particular that rule 2 would apply to an option to lease or an option to acquire a leasehold interest unless the option to lease is an option to renew the lease or to acquire a leasehold interest that is reversionary on the term of the lease.)

I have set out below in point form a number of observations that are a practical importance. Before referring to them however, an incidental matter concerns the question of whether a long term lease

⁵Oosterhof and Rayner Canada Law Book Inc. 1985 volume 1, Paragraph 1107.110 contracts, options and commercial transactions

that is subject to forfeiture might be caught by the Rule. The answer is that it is not.⁶

Practical Observations

1. An option to acquire a leasehold interest that is not an option to renew an existing leasehold interest or to acquire a leasehold interest that is reversionary on the term of the lease will be invalidated if it breaches the Rule. Accordingly, an agreement in the form of a pure option to lease, or an agreement to lease where the agreement is conditional upon the satisfaction of conditions that may occur outside of the Perpetuities Period may be invalidated.
2. An option to expand leasehold premises under a long term lease could be held to be invalid because in this case, the right is not exercisable on the reversion of the lease but is actually exercisable during the term of the lease. By implication an option to expand entails the obtaining of a leasehold interest in lands additional to those that are already leased to the tenant. (To avoid the problem it might be preferable to create the leasehold interest in a long term lease, so as to affect immediately the lands subject to the option but sublease them back to the landlord subject to a right of termination on the part of the tenant (sub-landlord) when it exercises its option to expand.)
3. It is not enough for an option to acquire a reversionary interest to be included in the lease. It must be exercisable only by the tenant and its successors and assigns. Therefore, any provision that has the effect of allowing the option to be transferred by the tenant separately from the leasehold interest might attract the application of the Rule.
4. Options to renew or extend the term of the lease are not affected by the Rule.
5. A right of first refusal being a mere preemptive right which does not create an interest in land is not subject to the Rule.
6. An option to purchase the reversionary interest in land leased to a tenant will not be caught by the Rule so long as the option is exercisable during the term or within 1 year after the end of the term.
7. An option to acquire an easement at the end of a term is caught by the Rule but, the Perpetuity Period for this purpose is 40 years. This may have a very important impact on a ground tenant that constructs improvements on a piece of land that are essential to the operation of other improvements on adjoining land that the tenant owns or leases. For example, if a building on one parcel required access over the second parcel which is leased to the tenant, or was dependent on parking or other facilities situated on that other parcel

⁶Anger and Hansburger Real Property Second Edition Paragraph 1104.21 page 508 volume

leased to the Tenant then, an option for the tenant to obtain an easement in favour of the adjoining land owned by it, exercisable at the end of the term of a lease could be voided if the lease were longer than 40 years in duration. (The solution might be to grant the easement immediately and make it subject to termination at the option of the tenant within some stated period after the end of the ground lease term.)

Conclusion

Since the Rule even as modified by the Act applies “remorselessly”, and, is intended to actually defeat the intention of the parties when that intention offends the Rule, it is critical to understand when it applies and when it does not. Moreover, in most cases, the practical and business objectives of the parties can easily be achieved by simply drafting around the rule. The Rule is esoteric, but, a practitioner can easily prepare a set of guidelines by reviewing the Act and the relevant texts. Therefore, there is no real excuse for running afoul of the Rule’s application in the context of leases.