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"THE LAW OF SURRENDER OF LEASES"

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THE LAW OF SURRENDERS OF LEASES

I. INTRODUCTION

A surrender of a lease is the yielding or delivery up of real property by one who leases the property (the lessee) to he who has the next higher estate (the lessor). When a lease is surrendered, the lease ends (and along with it, the rental and other obligations under the lease). Following the surrender date, all lease obligations (and rights) cease to exist; however, unfulfilled obligations prior to the surrender date remain actionable (subject to any limitation periods).

In the common law provinces of Canada, there are some quirks around surrenders that every commercial leasing practitioner should understand. These quirks will be explored in this paper. A word of caution: this law is not entirely applicable in the civil law province of Quebec, nor does it translate *holus bolus* into any statement of general application in the United States.

The first point to be aware of is that a right cannot be surrendered – it must be property that is surrendered. The property that is surrendered must be an estate or interest that is vested, ie the lessee must have taken possession. Accordingly, if the lessee has not yet taken possession then it has only a right and not a vested interest. However, if the lessee has entered into possession but its assignee has not, the assignee may surrender before entry.¹ It is possible to surrender a part only of the demised premises, but the *whole* of the interest or estate in the demised premises must be surrendered.²

¹ *Williams and Rhodes' Canadian Law of Landlord and Tenant*, 6th ed by C.A.W. Bentley, J.H. McNair and M.J. Butkus (Toronto: Carswell, 1988), para. 12:2:1

² *Baynton v. Morgan* (1988), 22 Q.B.D. 74 (C.A.), *Burton v. Barclay* (1831), 131 E.R. 288.

There are two types of surrenders of leases: (1) an express surrender, and (2) surrender by operation of law. The effect of a surrender by operation of law is effectively the same as that of an express surrender, i.e. the lease ends as does the rental and all other obligations under the lease.

The legal impact, on a *sublease* (or *underlease*), of the surrender of the head lease, is a topic for another paper another day.

II. EXPRESS SURRENDERS

An express surrender (aka “surrender in fact”, or “surrender by deed”) is typically accomplished by way of a written surrender agreement coupled by the act of delivering possession. According to Williams & Rhodes³, the proper operative words are “surrender and yield up”, but strictly speaking, no technical words are necessary. An act of surrender by mutual consent of the parties need not always be in writing but the exceptions to the rule are difficult to discern from the case law. Because “surrender by operation of law” which is not accompanied by a written surrender agreement is a close cousin of “express surrender by act of the parties”, any confusion is eliminated by the presence of a written surrender agreement (aka “deed of surrender”).

³ *Supra* note 1 at para. 12:2:2. The requisites of an express surrender are set out therein.

There is a legal requirement that the surrender must take effect at once and cannot operate in the future⁴, as a result of which it has become common practice to document an agreement to surrender premises as of a future date by way of a lease amending agreement that reduces the Term. The document takes the form of an ordinary surrender agreement only if it is done concurrently with or after the fact, in which case it is written/dated as of the surrender date.

III. SURRENDER BY OPERATION OF LAW

Surrender of a lease by operation of law is a concept closely related to the law of estoppel. It can occur if there is “anything which amounts to an agreement on the part of the tenant to abandon and on the part of the landlord to resume possession of the premises”.⁵ The question of whether the landlord’s conduct amounts to an acceptance is at the heart of surrender by operation of law. Each case turns on its facts, and the burden of proving a surrender is on the person who alleges it⁶.

For example, surrender occurred when a landlord accepted the tenant’s keys, converted the premises into a storage facility and removed the tenant’s sign redirecting customers.⁷ Surrender was also found to occur when the landlord’s notice to quit was wrongfully given to the tenant but the tenant acted upon it by giving up possession, which the landlord accepted.⁸

⁴ *Re Humphrey and Ont. Housing Corp.* (1979), 23 O.R. (2d) 583 (Div. Ct.)

⁵ *Phene v. Popplewell* (1862) 142 E.R. 1171 at 1174.

⁶ *Harrison v. Leopold*, [1950] 2 D.L.R. 563 (N.S.C.A.)

⁷ *Caygeon Enterprises Ltd. v. Ingram* [2005] O.J. No. 6304 (Ont. Superior Court of Justice). The landlord’s actions were inconsistent with the continued operation of a lease.

⁸ *Harrison v. Leopold* [1950] 2 D.L.R. 563, 25 M.P.R. 46 (N.S. C.A.); *Sandum v. Holmes* (1985) 57 A.R. 300, 16 D.L.R. (4th) 629 (C.A.).

In another case, surrender was held to have occurred where the landlord had leased the premises to a fresh tenant for the balance of the term and included an option to purchase in the new lease⁹.

The inaction of a landlord may also evidence acceptance of surrender. For example, surrender by operation of law has been held to occur where a sub-tenant notified the landlord and tenant of its intention to surrender the premises on a fixed date and the landlord did nothing to exercise its options for the repudiation of the lease.¹⁰ Similarly, a landlord accepted the tenant's keys without protest and made no mention (at any time) to the tenant regarding an obligation to pay further rent¹¹. The landlord's acceptance was "complete and unequivocal".¹² "There is a delivery of possession sufficient to effect a surrender when the tenant returns the keys of the premises, and the landlord accepts them with the intention of changing possession".¹³

Generally speaking, if the tenant gives up possession of the premises and the landlord accepts possession of the premises, then surrender has been effected. However, the courts have not always found surrender by operation of law where this has occurred.

In one instance, the court held that surrender did not occur when, upon the tenant vacating the premises, the landlord advertised the premises for rent, cleaned the premises, performed small repairs to maintain and protect the premises – but also notified the tenant that it

⁹ *South End Dev. Co. v. E.B. Eddy Co.* (1970), 16 D.L.R. (3d) 89 (N.S.C.A.)

¹⁰ *Daulat Investments Inc. v. Ceci's Home for Children* [1991] O.J. No. 2029 (Gen. Div.).

¹¹ *Levesque v. J. Clark & Son Ltd.* [1972] 7 N.B.R. (2d) 478 (N.B.Q.B.).

¹² *Ibid* at para 9.

¹³ *Ibid* at para 9 citing Halsbury (3d ed) Vol. 23 at 685.

was still liable for the payment of rent.¹⁴ The court found that to amount to surrender, the keys must have been delivered to the landlord on the understanding that the tenant was leaving the premises and that rent would cease. “Something must be shown to have taken place which is inconsistent with the continuance of the lease, something which raises an estoppel against the landlord and tenant to assert it, in order to effect a surrender in law”.¹⁵

Acceptance of the keys by the landlord does not, in itself, constitute surrender. For example, the court found that there was no surrender where a landlord accepted the keys out of concern for the security of the property and made it clear that the lease remained in full force, there was no forfeiture and no surrender of the lease.¹⁶ In another case, the tenant abandoned the premises and the landlord accepted the keys, but it claimed that it did so in order to allow it to inspect the premises, get estimates and make the necessary repairs – and this conduct did not, according to the court, amount to surrender.¹⁷ Surrender by operation of law likewise did not occur when a tenant’s manager handed over the keys in response to a demand from the landlord and not because it was agreeing to surrender.¹⁸ (The tenant defaulted with respect to payment of certain taxes and the landlord notified it of the default and required that it be cured within thirty days. The landlord accepted the next rent due but subsequently demanded the keys and entered into possession. It was held that when the tenant handed over the keys, this did not signify an agreement by the tenant to surrender).

¹⁴ *Ontario Industrial Loan and Investment Co. v. O’Dea* [1895] O.J. No. 44, 22 O.A.R. 349 (Ont. C.A.).

¹⁵ *Ibid.*, at para 22.

¹⁶ *Commercial Credit Corp. v. Harry D. Shields Ltd.* (1980) 29 O.R. (2d) 106, 15 R.P.R. 136, 1 P.P.S.A.C. 99, 112 D.L.R. (3d) 153 (H.C.) aff’d (1981) 32 O.R. (2d) 703, 1 P.P.S.A.C. 301, 122 D.L.R. (3d) 736, 14 B.L.R. 121 (C.A.).

¹⁷ *Hum v. Mosher and Atlantic Pizza Delight Franchise (1968) Ltd.* (1977), 33 N.S.R. (2d) 135, 57 A.P.R. 135 (N.S. County Ct. for District Number One).

¹⁸ *Royal Inns of Can. Ltd. v. Bolus-Revelas-Bolus Ltd.* (1982) 37 O.R. (2d) 339, 136 D.L.R. (3d) 272 (C.A.).

The following scenarios were held to amount to surrender by operation of law:

- A tenant assigned the lease to its creditors who did not take possession of the premises. The landlord requested keys from the tenant, cleaned up, performed repairs and painted over the tenant's business sign.
- A tenant did not give proper notice to exercise an option to renew before the lease expired. The tenant continued in occupation after the termination of the first term. Subsequently, the tenant agreed to accept, in lieu of the five year extension, a three year extension. The tenant was estopped from claiming that the renewal term was to be longer than three years as it had effectively surrendered the last 2 years.
- A landlord leased a farm for ten years. The tenant remained in possession for only six months. The tenant gave up possession and the landlord relet the premises without notifying the tenant that the reletting was on the tenant's account.
- A landlord reentered on default for payment of rent and performed repairs to the building.
- A tenant was in arrears. By a letter agreement signed by both parties, the landlord required the tenant to vacate the premises at the end of the month and pay all arrears. Before the end of the month, the tenant, without having paid, moved its belongings to new offices and handed over the keys to the landlord. The landlord accepted the keys without indicating to the tenant that its possession of the premises was for a purpose other than surrender.

The following scenarios were held NOT to amount to surrender by operation of law:

- A landlord sought to recover a year's rent. The tenant harvested crops on a farm which were destroyed by fire, and the tenant was paid the insurance proceeds. The tenant left

the farm. Although the landlord entered, ploughed and put in a crop, it repeatedly demanded payment of rent from the tenant.

- A tenant repudiated the lease. The landlord informed the tenant that it remained liable for the breach.
- A tenant gave written notice that it was leaving the premises. The landlord put up a sign to rent the premises.
- A tenant was in arrears. The landlord and tenant met to discuss the matter. There was conflicting evidence with respect to what was decided between the parties. However, the tenant did not give up possession.
- A landlord entered to perform repairs and protect the premises.

Clearly, there can be some difficulty in predicting when surrender by operation of law arises and when it does not. This leads to concern on the part of landlords as to what is the best course of action to take upon abandonment of the premises by the tenant. Landlords will typically want to re-take possession of the premises and re-let them to another tenant but are concerned that this action may be construed as acceptance of a surrender. Attached is a sample form of notice that can be used by a landlord to clarify that there has been no acquiescence and that the landlord intends to continue to hold the tenant liable for the rent.

It has been held that surrender occurs and a new lease is granted when a lease is amended so that there is an additional term, extending extended beyond the original term.¹⁹ In this situation, because there is a new contractual relationship between the assignee and the landlord,

¹⁹ *Re Savile Settled Estates* [1931] All E.R. Rep. 556; *Baker v. Merkel* [1960] 1 All E.R. 668 (C.A.).

there is no longer privity of contract between the landlord and the original tenant. Accordingly, the continuing liability on the part of the assignor comes to an end upon the deemed surrender. However, this general rule is not universal. It has also been held that minor amendments with respect to a reduction (or an increase) in rent does not create a new lease or cause a surrender by operation of law.²⁰

IV. FAILURE TO RENEW A HEAD LEASE AMOUNTING TO A SURRENDER

The most interesting recent case on the law of surrender is *McDonald's Restaurants of Canada Ltd. v. Grall Corp.*²¹ in which the tenant had negotiated a lease of a building with its landlord who was a lessee under a ground lease for a term of years including options to renew. The lease contained a covenant by the landlord to exercise its options to renew so that in turn, the tenant's options to renew could be exercised. The tenant was concerned that if the landlord were to fail to exercise its options to renew under the ground lease, the tenant's options to renew contained in its underlease would fall away. To protect its investment, the tenant obtained a non-disturbance agreement from the ground lessor (head landlord), in which the head landlord assured the tenant that if the ground lease were surrendered or terminated, the head landlord would accept the tenant as a direct tenant on the terms of its lease. The landlord (ground lessee) exercised its first and second renewal options under the head/ground lease. It failed to exercise its third renewal option. Despite the head landlord's assertion that it specifically did not agree to extend the non-disturbance protection to the situation where the ground lessee failed to exercise an option to renew, but only agreed to extend the protection to the situation where the ground

²⁰ *Jenkin R. Lewis & Son Ltd. v. Kerman* [1969] M. No. 1847 (C.A.); *Pye v. Bank of Montreal* [1986] N.S.J. No. 203 (C.A.).

²¹ [2007] O.J. No. 526 (Sup. Ct.)

lease was terminated for default or was surrendered, the court came to the conclusion that the non-renewal of the head (ground) lease amounted to a surrender. It came to this conclusion because it found that to rule otherwise would lead to a commercially unreasonable, unfair result.

V. CONCLUSION

The law of surrender is a wolf in sheep's clothing. It seems that the concept should be very simple and straightforward. But as the preceding summary reveals, if one is not prepared for the myriad of ways in which fairly ordinary landlord-tenant conduct might be construed by the courts, then one just might get bit!

**SAMPLE
NOTICE**

Date

DELIVERED

Tenant's Legal Name
[Address for Notice According to Lease]

Dear Sirs:

**RE: Landlord's Legal Name ("Landlord") - Tenant's Legal Name ("Tenant")
- Lease dated * ("Lease") - Address of Premises ("Premises")**

On **, you abandoned the Premises and, since then, have not operated your business in the Premises. No rental payments have been made since **.

The Landlord has treated the above-mentioned acts as a complete repudiation and termination of the Lease and the Landlord has, therefore, taken possession of the Premises.

The Landlord's acceptance of your repudiation and termination is without prejudice to all of the Landlord's rights under the Lease and at law, including, without limitation, its claim against the Tenant for (i) any outstanding amounts of Rent payable under the Lease; (ii) interest on any outstanding amounts as set forth in Section ** of the Lease; (iii) all payments of annual Net Rent, Additional Rent and other sums and charges in arrears or accruing due over what would have been the unexpired Term of the Lease had it not been terminated; and (iv) all damages suffered by the Landlord (including all legal and other costs and expenses incurred by the Landlord in connection with the termination of the Lease and in reletting the Premises).

If you would like to claim any property located on the Premises which belongs to you, please contact the undersigned directly. If any of your property is not claimed within ** days after the date of delivery of this letter, then such items may be removed and disposed of by the Landlord on your behalf as it sees fit and at your expense.

Yours very truly,

Landlord's Legal Name

Per: _____
Name:
Title:

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