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**"LEASEHOLD COVENANTS
– DO LEASEHOLD COVENANTS RUN WITH THE LAND?"**

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Leasehold Covenants – Do Leasehold Covenants Run With the Land?

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Introduction

Many landlords and tenants believe that upon a sale of a property, the transferee of the landlord's interest is obliged to perform all of the landlord's covenants under the lease and to honour all of the rights granted to the tenant thereunder. Similarly, they believe that upon an assignment of a leasehold interest by the tenant, the assignee is obliged to perform all of the tenant's covenants under the lease and entitled to demand performance of all of the covenants of the landlord. In Canadian common law jurisdictions, this is not necessarily the case. Leasehold covenants that attach only to the parties to the lease might not transfer to the assignee of either party – they might fall away.

The Leasehold Covenant

Examples of covenants in leases include:

- (a) *by landlord in favour of tenant* – to heat, to repair, to provide utilities, to insure, not to lease to competitors, to provide quiet enjoyment;
- (b) *by tenant in favour of landlord* – to pay rent, to maintain, to carry on only a specified use, not to commit waste, to insure, not to assign or sublet, not to open another outlet within a certain radius of the premises (to protect percentage rent based on the tenant's sales).

Sometimes leasehold covenants, like contractual terms, can be void for uncertainty/ambiguity¹. Other times, leasehold covenants have been held to be unenforceable for public policy reasons².

Some lease terms are actually considered to be separate agreements (e.g. an option to purchase³) or are not covenants at all but are mere conditions or qualifications on rights.⁴

Assuming the lease term is one that qualifies as a covenant, we turn to a consideration of whether it might be one that will "run with the land" (i.e. bind successors and assigns).

Covenants that Run with the Lease vs. Those that are Personal – The Law

*Williams and Rhodes*⁵ sets out that the “following propositions or rules are laid down in or deduced from the principles formulated in [*Spencer’s Case*]⁶”:

- (1) all express covenants which touch or concern a thing *in esse*, being parcel of the demise at the time of the demise, whether “assigns” are named or not, run with the land;
- (2) all express covenants which extend to a thing not *in esse* at the time of the demise, but which directly concern or benefit the land, being parcel of the demise, run with the land, if “assigns” are expressly named in the covenants;
- (3) all implied covenants run with the land;
- (4) covenants under which the thing to be done is merely collateral to the land and **does not touch or concern the land** demised in any sort of way, do *not* run with the land, even though “assigns” are named.⁷

It is virtually impossible to find, from the case law, any meaningful guidance as to whether or when it is necessary/beneficial to import a reference to ‘assigns’ to achieve or avoid a covenant that runs with the lease.

To displace doubts in relation to whether covenants ought to or will run with the leasehold interest or not, it is widely accepted in the Canadian commercial leasing industry as a best practice by landlords, that special rights (such as rights to signage, exclusivity, expansion, co-tenancy protection, exclusive parking, no-consent Transfers) should be qualified as only available to the named tenant, to ensure that they do not flow-through to an assignee (if that is the deal).

In the case of *Merger Restaurants v. D.M.E. Foods Ltd.*⁸, 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. In *Nylar Foods v. Roman Catholic Episcopal Corp. of Prince Rupert*⁹, the court held:

If it is not entirely clear from the language that the parties intended to create an equity or correlative burden on the land, the restrictive covenant will be treated merely as a personal covenant between the parties who made it.

It follows that if a covenant is merely personal, then it will be enforceable as a matter of the law of contract but not enforceable in accordance with the principles of real property.

As noted earlier (footnote 7), an option to renew is an *in rem* covenant, concerns a thing *in esse* and runs with the land (and correspondingly, the leasehold interest). A restriction against competitors concerns use and therefore touches and concerns land and is an *in rem* covenant.

Many leasehold covenants are not susceptible to easy analysis as to whether they are *in personam* vs *in rem* covenants. The test, set down in *Rogers v. Hosegood*¹⁰, is that “the covenant must either affect land as regards mode of occupation, or it must be such as per se, and not merely from collateral circumstances, affects the value of the land”.

Courts have held that the covenant not to build on adjoining land is a covenant *in rem* that runs with the land¹¹. But landlord covenants that have been held by the courts as not being

ones that touch and concern the land, include: the covenant to grant an option to purchase the lands¹², the covenant to keep other properties (not the leased premises) in repair¹³, and the covenant not to open a competitive enterprise within a radius from the leased premises¹⁴.

Following is a brief listing of some tenant's covenants that have been held to "touch and concern" the land:

- Pay rent ¹⁵
- Pay taxes ¹⁶
- To repair ¹⁷
- To insure against fire ¹⁸
- Not to assign without the landlord's consent ¹⁹
- To buy particular goods from only the landlord ²⁰

as well some tenant's covenants that have been held to NOT touch and concern the land:

- To pay a third party annually ²¹
- To pay taxes imposed on another property ²²
- To replace personal property ²³

The Case Law

In the case of *Re Dollar Land Corporation and Soloman*²⁴, the tenant had paid a security deposit to the landlord. Dollar Land Corporation later purchased the property from the landlord, subject to all the leases pertaining to the property. At issue was whether Dollar Land Corporation was liable to the tenant for the security deposit. In finding that the new landlord was not liable to account for the security deposit, the court held that the covenant to repay the security deposit did not run with the land and was, therefore, not binding on the assignee. Although *Re Dollar Land*

concerned a residential tenancy, it has since been followed in several cases concerning commercial tenancies.²⁵

*Devon Estates Limited v. Royal Trust Co.*²⁶ concerned a tenant who occupied office space in Calgary. As the result of a refinancing by the landlord in 1991, Royal Trust became the trustee of bondholders and in 1993 commenced foreclosure proceedings, took possession of the premises and executed a request to attorn to the tenant. The application by the tenant related to possible overpayments of so-called “additional rents” - as was to be determined by an arbitration then underway. These payments had been made to the former landlord. In finding Royal Trust not liable to account for the overpayments, MacLeod J. reviewed a number of cases (including *Re Dollar Land and Chiappino v. Bishop*²⁷). The Court held that the request to adjust the difference between estimated and actual operating costs was not an adjustment in the amount of rent; it was an obligation to repay a sum of money that was triggered by the arbitration process. The obligation to repay was therefore no different from the obligation to return a deposit.

Similarly, in *Canada Trustco Mortgage Co. v. Mundet Industries Ltd.*²⁸, the Court held that the tenant had no claim against the current landlord for the return of a GST payment made to the former landlord.

In *Brennan v. Dole*²⁹, neighbouring townhouse owners engaged in a dispute over snow removal costs. The townhouse developer executed an agreement with each initial owner that provided for the sharing of costs of snow removal from a common right of way and for resolution of disputes under the Agreement by arbitration. A successor in title to one of the five original townhouse owners did not want to go to arbitration to settle the dispute. She argued that the arbitration clause was unenforceable because it was a positive covenant that did not bind her (as a successor in title who did not specifically assume the obligations of the covenant), and that

it did not run with the land. The Court of Appeal agreed. Leasehold covenants are not of the same nature as terms in a cost-sharing agreement between landowners, yet *Brennan* was referred to in a commercial lease dispute, in the case of *678400 Ontario Inc. v. Roehampton Apartments Ltd.*³⁰ (where the landlord and tenant were disputing the rent to be paid for a renewal period). The original lease stipulated arbitration as the dispute resolution mechanism. The landlord and tenant were not the original parties to the lease. The tenant submitted that the agreement to arbitrate is a positive covenant that does not run with the land. The tenant relied on the decision in *Brennan*. The court rejected the tenant's argument, finding that the arbitration clause was not a collateral covenant to the lease.

Let's break down the three types of situations one might encounter, in which a determination of whether the covenant ran with the land might become relevant:

1. original landlord and successor tenant;
2. successor landlord and original tenant;
3. successor landlord and successor tenant.

An assignment by the original landlord or the original tenant does not affect the privity of contract between the original tenant and original landlord (unless the parties expressly agree to a release). However, the assignment ends the privity of estate between the original tenant and original landlord. (When a tenant enters into a lease with a landlord there is not only privity of contract but also privity of estate between them. That is to say, the covenants of the landlord and of the tenant which relate to the conveyance and the real property interest, or which touch and concern the land as distinct from being mere covenants of a personal nature, can be enforced as between them. Privity of estate and tenure are essentially the same thing, in that where they are found to exist, those who hold the estate together are liable to each other to perform the

covenants which relate to the estate.) However, covenants of a personal nature (such as an option to purchase) cannot be enforced between parties who are merely connected by privity of estate. Privity estate is always held by the then-current landlord and then-current tenant.

Hence, an assignor of a tenant's interest remains liable in contract although it no longer has the estate (although a subsequent assignor will only remain liable in contract if it contracted to be bound, i.e. if it took on privity of contract in addition to the privity of estate that arose during its tenure).

The Solution? Assumption Agreements

An assumption agreement is a useful tool that serves to clarify the answer to, “does/did the covenant run with the land/lease”?

It is common in Canadian commercial leasing practice to require that the assignee of a tenant's interest under the lease sign an agreement in which it covenants, in favour of the landlord, to perform the obligations of the tenant under the lease. This type of “assumption agreement” will create the privity of contract, whereas the assignment of the interest created the privity of estate - with the result that for the landlord, both a contractual and a property law relationship are available when considering remedies for unfulfilled lease terms. In this manner, a ‘gap in coverage’ is avoided (if any covenants fail to attach to an assignee), i.e., the assignee picks up each and every covenant of the tenant, whether or not it would have otherwise run with the land.

It is also a common step in real estate conveyancing transactions that the vendor extracts from the purchaser an assumption of all leasehold covenants. But it is far less common in Canadian commercial leasing practice that a tenant obtains a covenant, from a purchaser of the

landlord's interest in the lease, to perform and observe all of the terms and conditions of the lease.

In Ontario, pursuant to the *Commercial Tenancies Act*³¹, ss.4 - 8, the common law rule that positive covenants do not run with the reversion was, by and large, reversed. Many other common law provinces have similar legislation.³² Yet it is not clear that these provisions will help the tenant in all disputes against a successor landlord over its failure to perform a lease covenant. An assumption agreement (by the successor landlord in favour of the tenant) would fill that gap.

Fundamentally, assumption agreements are useful and reliable as a means of confirming (1) which leasehold covenants transfer to a successor/assign, and (2) who can enforce those covenants.

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ENDNOTES

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- ¹ *Hirex Holdings Ltd. v. Chrysler Canada Ltd.*, [1991] B.C.J. No. 669 (B.C.S.C.), and *Re: Spike et al and Rocca Group Ltd. et al* (1979), 107 DLR (3d) 62 (PEISC)
- ² *B.A.C.M. Ltd. and Kowall Holdings Ltd. et al* (1972), 28 D.L.R. (3d) 365
- ³ *Palmer v. Ampersand Investments Ltd.* (1984), 47 O.R. (2d) 275 (H.C.J.)
- ⁴ E.g., a lease of shopping centre premises may contain a provision stipulating that if a certain number of stores are not continuously carrying on business for a set number of days or months, the rental rate will be reduced. This type of provision carries no promise of stores carrying on business; if the stores do not carry on business, the landlord is not in default and there can be no claim for damages or entitlement to other remedies. The failure to achieve the threshold level of occupancy is a condition that gives rise to an agreed set of outcomes (which typically include reduced rent and, after some time has elapsed without the occupancy levels being restored, a right of termination without liability). But there is no covenant by the landlord to maintain a certain occupancy level which would, if unfulfilled, give rise to a claim for breach. In a similar vein, a lease may contain a provision prohibiting the tenant from assigning the lease to a third party without the landlord's consent. The prohibition against assigning is a covenant and the landlord's consent might be considered a mere qualification, such that the landlord's failure to consent would not give rise to a claim for breach, although the courts have held otherwise. In *Cvokic v. Belisario*, [2008] O.J. No. 2766 and in *Lehndorff Canadian Pension Properties Ltd. v. Davis Management Ltd.*, [1987] B.C.J. No. 1228, the landlord was liable for unreasonably withholding consent.
- ⁵ 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).
- ⁶ *Spencer's Case* (1583), 77 E.R. 72.
- ⁷ Briefly, the meaning of '*in esse*' is 'in existence', i.e. this relates to something that exists, i.e. an existing lease interest, a building on a property, not something that will exist in the future.) Williams & Rhodes gives examples of express covenants which touch or concern a thing *in esse*, including 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 build a mill in place of an old one, to erect a building, 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. 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 a thing *in esse*. Hence, a covenant to renew binds 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.
- ⁸ [1990] M.J. No. 319 (Man. C.A.) (QL)
- ⁹ (1988), 48 D.L.R. (4th) 175 (B.C.C.A.)
- ¹⁰ [1900] 2 Ch. 388 at p. 395 (C.A.).
- ¹¹ *Dewar v. Goodman*, [1909] A.C. 72 (H.L.); *Ricketts v. Enfield Churchwardens*, [1909] 1 Ch. 544.
- ¹² *Woodall v. Clifton*, [1905] 2 Ch. 257 (C.A.).
- ¹³ *Supra*, note 11.
- ¹⁴ *Thomas v. Hayward* (1869), L.R. 4 Ex. 311.
- ¹⁵ *Williams v. Bosanquet* (1819), 1 Brod. & B. 238, 129 E.R. 714, *Parker v. Webb* (1963), 3 Salk. 5
- ¹⁶ *Mackinnon v. Crafts, Lee & Gallinger* (1917), 33 D.L.R. 684 (Alta. C.A.)
- ¹⁷ *Perry v. Bank of Upper Canada* (1866), 16 U.C.C.P. 404
- ¹⁸ *Douglass v. Murphy* (1858), 16 U.C.Q.B. 113
- ¹⁹ *Goldstein v. Sanders*, [1915] Ch. 549; *Cohen v. Popular Restaurants Ltd.* [1917] 1 K.B. 480
- ²⁰ *Rudd v. Manahan* (1913), 11 D.L.R. 37 (Alta. C.A.), affg 5 D.L.R. 565 (Alta. S.C.)
- ²¹ *Mayho v. Buckhurst* (1617), Co. Jac. 438
- ²² *Gower v. Postmaster-General* (1887), 57 L.T. 527
- ²³ *Gorton v. Gregory* (1862), 3 B & S 90, 122 E.R. 35
- ²⁴ [1963] 2 O.R. 269.

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- ²⁵ See for example: *Devon Estates Limited v. Royal Trust Co.*, [1995] 2 W.W.R. 293 (Alberta Queen's Bench) and *Canada Trustco Mortgage Co. v. Mundet Industries Ltd.*, [1996] O.J. No. 3746 (Ontario Ct. (Gen. Div.)).
- ²⁶ *Supra*, note 25.
- ²⁷ [1988] O.J. No. 763 (Ontario Ct. (Gen. Div.)).
- ²⁸ *Supra*, note 25.
- ²⁹ [2005] O.J. No. 3904 (C.A.)
- ³⁰ [2006] O.J. No. 5021 (Sup.Ct.J.)
- ³¹ R.S.O. 1990, c. L.7
- ³² **NWT and Nunavut** - Commercial Tenancies Act, R.S.N.W.T. 1988, c. C-10 ss. 2(3),(4), s.3, s.4
Yukon - Landlord and Tenant Act, R.S.Y. 2002, c. 131 s.2, s.3
Manitoba - The Landlord and Tenant Act, R.S.M. 1987, c. L70 s.3, s.4, s.5, s.6, s.7
Saskatchewan - The Landlord and Tenant Act, R.S.S. 1978, c. L-6 s.3, s.4, s.5, s.6
New Brunswick - Landlord and Tenant Act, R.S.N.B. 1973, c. L-1 ss. 2(1),(2),(3), s.3
P.E.I. - Landlord and Tenant Act, R.S.P.E.I. 1988, c. L-4 ss. 2(1),(2),(3), s.3, s.4