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PDF # 5-7

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Shopping Centre Newsletter, Vol. 21, No. 11
November 2001

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LEASING LAWS

WHEN A SUBLEASE IS REALLY AN ASSIGNMENT

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An assignment of lease and a sublease are similar because in both of them, the tenant gives up possession of the premises to another party. However, on other fundamental ways, they are different.

When a tenant assigns its lease, it transfers its tenancy to the assignee and ceases to have any tenancy interest in the premises.

The assignee becomes the direct tenant of the landlord, who can still sue the tenant if the tenant's obligations are not performed (this applies whether the default occurs before or after the assignment).

If the assignee (the new tenant) defaults and the assignor (the former tenant) cures the default, it is still the new tenant who retains the right to occupy the premises. The former tenant cannot force the landlord to allow it to regain possession.

If a tenant subleases to another party (a 'subtenant') the tenant becomes the landlord (a 'sublandlord') of the subtenant and retains its tenancy with the original landlord (the 'headlandlord').

Unless the subtenant enters into an agreement directly with the headlandlord, the headlandlord has no right to make the subtenant perform obligations under the lease (the 'headlease').

The terms and conditions of the sublease are often different from those of the headlease. In fact, the term of the sublease must be different from the headlease because the expiry of a sublease must precede the expiry of the headlease.

Otherwise, there would be no 'reversionary interest' in the party that purported to create a sublease. If it has no reversionary interest, a party can't be a landlord.

In that case, the lease is considered to be assigned, and the party that is intended to be a subtenant instead becomes the direct tenant of the party that was supposed to be the headlandlord.

This occurred in the recent Ontario case of *Goldman v. 682980 Ltd. [2001] O.J. No. 3005 (Sup. Ct.)*. The lease contained an option in favour of the tenant to purchase the premises. The tenant, with the express written consent of the landlord, signed a document which stated expressly that it was a sublease but the expiry date and time of the term was the same as that of the headlease.

After the sublease document was executed and the 'subtenant' took possession, the tenant attempted to exercise its option to purchase. The landlord maintained that because the term of the so-called sublease was equal to the balance of the term of the lease, the lease had been assigned.

This meant that the so-called 'subtenant', as the direct tenant of the landlord, was the only party entitled to exercise the option to purchase. The party that signed the document as sublandlord was no longer the tenant under the lease and therefore could not exercise the option to purchase.

The tenant argued that Section 3 of the Commercial Tenancy's Act of Ontario (a section unique to Ontario) should apply. Section 3 provides that it is not necessary for a person to have a 'reversionary interest' in order to create a tenancy.

The tenant argued that even though the term of its lease was not longer than the term of the lease to its subtenant, there was a valid sublease and there was no need to treat the transaction as an assignment.

However no case could be found where Section 3, since its enactment over 100 years ago, had been applied in similar circumstances and the judge chose not to be the first to do so. The case is under appeal. In the meantime, the old law prevails.

The best way to avoid this problem is for the sublease term to end at least one day before the expiry of the headlease.

However, if the 'sublease' document in the Goldman case had been for a term that ended even a fraction of a minute before the end of the term of the lease, the problem could have been avoided.