

**“I SURRENDER!”**  
**A PRACTICAL REVIEW OF THE LAW OF SURRENDERS OF LEASES**

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This paper provides a summary of the law of surrenders (and partial surrenders) of commercial leases. In particular, I will review the legal and practical aspects of express surrenders, the rarely acknowledged doctrine of deemed surrender and regrant (and why, as a commercial leasing lawyer, you absolutely need to know about this doctrine), and partial surrenders of leases. Before launching into these topics, the following section contains a general discussion of what surrenders are, the legal requirements for surrenders and the effect of surrenders.

### **Surrender Basics**

A surrender of a lease occurs when the holder of a lesser estate (i.e. a tenant) yields up or delivers its premises to another party who has a higher and greater estate in those premises (i.e. a landlord). When there is a surrender, the lease is at an end and all rights and obligations cease (including the obligation to pay rent). Subject to applicable limitation periods, a tenant will remain liable for any breaches of the lease or unfulfilled lease obligations committed or arising before the surrender date.<sup>1</sup>

As a technical matter, in order for an actual “surrender” to take place, the tenant’s right or interest in the premises must be vested; that is, possession of the premises by the tenant must have first occurred. A mere right to the premises cannot be surrendered<sup>2</sup> (however, as a practical

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<sup>1</sup> *Williams and Rhodes' Canadian Law of Landlord and Tenant*, (consulted on 15 December 2013), 6th ed (Toronto: Carswell, 2013) at para 12:2:2, online: Carswell eReference Library <<http://www.ereferencelibrarycarswell.com>> [*Williams and Rhodes*].

<sup>2</sup> *Ibid* at para 12:2:1.

matter, a tenant's right to the premises can be given up by way of a contractual agreement to that effect, it's just not a surrender). The rationale behind this concept is that entry by the tenant has the effect of dividing or severing physical possession from the reversion – once divided or severed, the property may then be surrendered back to the landlord. However, if a tenant has taken possession of the premises and assigns its interest to another party, the assignee may surrender prior to that assignee taking possession.<sup>3</sup> The initial entry by the original tenant is sufficient to create the division or severance referred to above.

A portion of the premises may be surrendered, but the tenant must surrender all of its interest or estate in that surrendered portion.<sup>4</sup> A more detailed discussion about drafting considerations for partial surrenders is set out below.

If a head lease is surrendered, both landlords and subtenants will need to be aware that there is a legal impact on any subleases for the premises being surrendered. For a comprehensive summary of the law on this topic, I refer you to a previous paper prepared for the Six-Minute Commercial Leasing Lawyer series.<sup>5</sup>

## **Types of Surrenders**

### **(a) Express Surrender**

An express surrender is made through the acts of the parties by way of a written agreement together with the actual physical surrender of the premises by the tenant to the landlord. The concept of an express surrender is sometimes referred to as “surrender by deed” or

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<sup>3</sup> *Ibid.*

<sup>4</sup> *Baynton v Morgan* (1888), 22 QBD 74 (CA); *Burton v Barclay* (1831), 131 ER 288.

<sup>5</sup> Natalie Vukovich, “*Surrendering and Terminating Subleases: How to Avoid the Potholes*” (Paper delivered at the Law Society of Upper Canada, Return of the Six-Minute Commercial Leasing Lawyer, 22 September 2000), [unpublished].

“surrender in fact”.<sup>6</sup> With certain exceptions, a written agreement is required for an express surrender; however, the exceptions are quite limited.<sup>7</sup> Accordingly, when parties agree to a surrender of premises, in order to effect an express surrender and avoid uncertainty, their intentions should be documented in a written surrender agreement.

When drafting a surrender agreement, no specific or technical language is required to effect the surrender (although it should be noted that *Williams and Rhodes* states that the operative words are “surrender and yield up”<sup>8</sup>). At law, the surrender must occur at once and cannot operate in the future.<sup>9</sup> As a result of this requirement, where parties agree that the tenant will surrender its premises to the landlord on a future date, a lease amending agreement is used instead of a surrender agreement. Under that lease amending agreement, the agreed upon “future surrender” is documented as an amendment to the lease whereby the length of the term is reduced to expire on an earlier date. The operative provision typically reads as follows: “The Lease is amended by reducing the Term to a period of \*(\*) years and \*(\*) months so that it will expire in accordance with the terms and conditions of the Lease on \*\*\*\*\* \*\*, 20\*\* (the “Expiration Date”)”.

An agreement that purports to be a “surrender agreement” should only be used to document a past or concurrent surrender (i.e. a surrender that occurs at the time the surrender agreement is entered into) and in those circumstances, the surrender agreement is made or dated as of the actual surrender date. Typically one of the recitals of the surrender agreement will

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<sup>6</sup> *Supra* note 1.

<sup>7</sup> *Supra* note 1 at para 12:3:1. There is no clear general rule for the exceptions across Canada. However, in some cases, if the interest could be granted by words and without writing, then it may be surrendered in the same manner. See e.g. *Statute of Frauds*, RSO 1990, c S19 s 3. See also *Wallbridge v Gaujot* (1887), 14 OAR 460 (ON CA) no written agreement was necessary to surrender the lease where under the terms of the lease the tenant had the right to terminate under certain circumstances, but the lease did not specify how the termination was to be effected.

<sup>8</sup> *Supra* note 1.

<sup>9</sup> *Re Humphrey and Ontario Housing Corp.* (1979), 96 DLR (3d) 567 (Ont H Ct J (Div Ct)).

contain language that describes the occurrence of the surrender similar to the following: “Subject to the provisions of this Agreement, the Tenant has surrendered the Lease and delivered up vacant possession of the Premises to the Landlord as of \*\*\*\* \*\*, 20\*\* (the “Expiration Date”)”.

In contrast to the lease amending agreement referred to above (which reduces the term to document the “future surrender”), a standard surrender agreement will contain language that describes the occurrence of the surrender and the effect of that surrender. The following is an example of this type of provision:

The Tenant acknowledges that it surrendered the Lease and the Premises to the Landlord as of midnight on the Expiration Date, together with all rights thereunder, to the intent that the unexpired residue of the Term of the Lease and any renewals or extensions, including any parking and storage rights, shall be merged and extinguished in the reversion to the Landlord, and the Tenant releases, as of the Expiration Date, all of its rights, title and interest in, and in respect of, the Lease and the Premises.

The remainder of the surrender agreement will set out the specific terms and conditions (including any early termination fees or other financial compensation) that the parties have agreed to in connection with the surrender; however, the following concepts should also be included:

- a clause that provides for final adjustments of additional rent and any percentage rent after the surrender date;
- a clause that provides for releases that take effect from and after the surrender date (but do not excuse liabilities or defaults that arose prior to that date);
- a clause that references the tenant’s removal and restoration obligations under the lease and a statement that those obligations will survive the surrender date. If the parties have agreed to alter the tenant’s lease obligations, the clause should set out the revised removal and restoration obligations;

- a clause that states that the tenant has delivered vacant possession of the premises to the landlord on the surrender date free and clear of all liens, charges and encumbrances;
- a clause to the effect that as of the surrender date the tenant has not and will not enter into any agreements under which the lease and the unexpired residue of the term (including any renewals or extensions) will be charged, encumbered, assigned or otherwise transferred; and
- a clause requiring the tenant remove any notices of lease from title to the property, failing which the landlord may do so at the tenant's expense.

**(b) Surrender by Operation of Law**

Surrender by operation of law occurs when there is no written surrender agreement but the landlord and tenant have engaged in conduct (including, in some cases, inaction on the part of the landlord) that amounts to an agreement that the tenant has given up possession of the premises and the landlord has accepted the surrender.<sup>10</sup> Surrender by operation of law is closely related to the doctrine of estoppel.<sup>11</sup> The burden of proving that there has been a surrender by operation of law is on the party that alleges it.<sup>12</sup> Not surprisingly, the case law on this topic reveals that the facts dictate the outcome. For a comprehensive summary of the circumstances and cases in which courts did or did not find that a surrender by operation of law occurred, I refer you to a previous paper prepared for the Six-Minute Commercial Leasing Lawyer series.<sup>13</sup> The following section of this paper deals with a type of surrender by operation of law that does not

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<sup>10</sup> *Phene v Popplewell* (1862), 142 ER 1171.

<sup>11</sup> *Supra* note 1 at para 12:2:4.

<sup>12</sup> *Harrison v Leopold*, [1950] 2 DLR 563 (NS SC).

<sup>13</sup> Natalie Vukovich, "The Law of Surrenders of Leases" (Paper delivered at the Law Society of Upper Canada, The Six-Minute Commercial Leasing Lawyer, 13 February 2008), [unpublished].

get nearly enough attention – the doctrine of deemed surrender and regrant.

## **Deemed Surrender and Regrant**

The doctrine of deemed surrender and regrant represents an example of surrender by operation of law, which takes effect regardless of whether the parties intended to effect a surrender.

So, what is this doctrine and why should commercial leasing lawyers know about it? The doctrine arises out of English case law which held that certain changes to a lease can result in the premises being surrendered and redemised by operation of law. A lawyer who is retained on a matter involving amendments to a lease will need to turn her/his mind to this doctrine as her/his client may inadvertently be effecting a surrender and redemise. When the doctrine is triggered, there can be practical consequences that may be significant and detrimental.

The leading case on deemed surrender and regrant is *Jenkin R. Lewis & Son Ltd. v Kerman*.<sup>14</sup> In *Jenkin*, the Court held that two agreements, which had the effect of increasing the rent payable under the lease, did not constitute a surrender and regrant of the lease as there was no evidence of an intention to create a new tenancy agreement. In arriving at its decision, the Court noted:

Viewing the matter apart from authority it is difficult to see why the fiction of a new lease and a surrender by operation of law should be necessary in this case; for by simply increasing the amount of the rent and providing that the additional rent shall be annexed to the reversion, one is not altering the nature of the pre-existing item of property.<sup>15</sup>

What arises from this case is the concept that a lease will be deemed to have been surrendered and regranted where the estate itself is altered. The principle is that the doctrine of

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<sup>14</sup> [1971] Ch 477, [1970] 3 All ER 414 [*Jenkin*].

<sup>15</sup> *Ibid* at 496-497 [emphasis added].

deemed surrender and regrant is triggered by amendments to a lease that fundamentally change the legal estate that has been granted. When these changes occur, the intention of the parties is irrelevant. In *Jenkin*, the Court noted:

If a tenant holding land under a lease accepts a new lease of the same land from his landlord he is taken to have surrendered his original lease immediately before he accepts the new one. The landlord had no power to grant the new lease except on the footing that the old lease is surrendered and the tenant by accepting the new lease is estopped from denying the surrender of the old one. This “surrender by operation of law” takes effect whether or not the parties to the new lease intended it to take effect. Moreover, even if there is no express grant of a new lease the old lease will be surrendered by operation of law if the arrangements made between the landlord and the tenant are such as can only be carried out so as to achieve the result which they have in mind if a new tenancy is in fact created.<sup>16</sup>

Unfortunately there is a lack of case law (in particular, a lack of Canadian case law) setting out the facts, circumstances and amendments that will give rise to a deemed surrender and regrant. There is also some inconsistency in the reported cases; however, the following principles emerge:

- As a result of the *Jenkin* case, it has been settled that minor contractual amendments such as increases or decreases in rent do not, without more, bring about a deemed surrender and regrant.<sup>17</sup>
- With respect to additions to the term of a lease, at law there is a distinction between the effect of an extension and a renewal. A renewal creates a new contract (and as such amounts to a deemed surrender and regrant) whereas an extension extends the original contract.<sup>18</sup> The practical significance of a renewal

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<sup>16</sup> *Ibid* at 496 [emphasis added].

<sup>17</sup> The following Canadian cases refer to *Jenkin*: *Sharpe v Parrell* (1989), 15 ACWS (3d) 442 (Nfld SC (TD)); *Silver Star Properties Ltd. v DeMarchant* (1990), 23 ACWS (3d) 1256 (NS Co Ct); *Power Motors Ltd. v Irving Oil Ltd.* (1996), 67 ACWS (3d) 604 (Nfld SC (CA)); *Hamilton Sportswear Co. v Clifford E Wilson Ltd.*, [1998] BCJ No 1849 (Prov Ct (Civ Div)).

<sup>18</sup> *Halsbury's Laws of Canada – Landlord and Tenant* at para HLT-115 (QL); *Baker v Merckel*, [1960] 1 All ER 668 (CA); *Avlor Investments Ltd. v JK Children's Wear Inc.* (1991), 6 OR (3d) 225 (Ont Ct (Gen Div)).

(which is, in effect, a deemed surrender and regrant) as opposed to an extension is set out below.

- In general, courts have rejected the notion that a reduction in the size of the premises amounts to a deemed surrender and regrant.<sup>19</sup> The rationale appears to be that a partial reduction does not alter what was initially granted to the tenant since the landlord still retains the reversionary interest in the retained portion of the premises and the tenant remains in possession of the retained portion.
- By contrast, there is case law that suggests that, in some circumstances, an addition to the premises will amount to a deemed surrender and regrant. In the *Jenkin* decision, the Court made the following remarks:

Again, if the parties wish further adjoining land to be added to the existing holding and the rent to be increased the transaction can, of course, be carried out by means of a separate lease of this fresh land at a separate rent. But if they wish there to be a single lease of all the land at an aggregate rent, the transaction may well amount in law to the granting of a new lease preceded by a surrender by operation of law of the old. However they express themselves it may well be that they cannot convert a rent of £X issuing out of the original land into a rent of £X + £Y issuing out of the aggregate land.

While there are some old Irish cases that held that an addition of premises does not cause a deemed surrender and regrant,<sup>20</sup> a more recent English case agreed with the statements in *Jenkin*.<sup>21</sup> Based on the *Jenkin* case and the case law that references that decision, the crux of causing a deemed surrender and regrant in circumstances where a lease is being amended to include additional premises appears to lie in merging the original premises with the new

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<sup>19</sup> *Watt v Marquis of Clanricarde* (1896), 30 ILTR 128; *Curoe v Gordon* (1892), 26 ILTR 95; *Thompson v Hagan* [1906] 1 IR 1; *Holme v Brunskill* (1878), 3 QBD 495. However, it should be noted that in *Jones v Bridgeman* (1878), 39 LT 500 a reduction in the premises was held to be surrender by operation of law.

<sup>20</sup> *Conroy v Marquis of Drogheda*, [1894] 2 IR 590; *Delmege v Mullins*, [1875] IR 9 CL 209.

<sup>21</sup> *Friends Provident Life Office v British Railways Board*, [1996] 1 All ER 336.



premises and providing for an aggregate rate of rent for the two premises that differs from the rental rate in the original lease. These amendments arguably affect the legal estate granted and could not take place unless the original lease was surrendered. The bottom line is that if a lawyer believes it is amending a lease in a manner that alters the estate, she/he must consider the doctrine of deemed surrender and its effects. In particular, leasing lawyers need to turn their minds to how amendments in respect of additional space will affect the original lease and whether a separate lease may be appropriate to avoid a deemed surrender and regrant of the original premises.

While this all might sound a little esoteric and technical, there are practical ramifications. A lawyer must be aware of them and must be able to advise her/his client about the possibility and implications of a deemed surrender and regrant.

In the case of a renewal of the term (as opposed to an extension), which as noted above, amounts to a deemed surrender and regrant, landlords will need to be advised that they cannot terminate the lease for a breach that occurred during the prior term (the tenant will still be liable for past defaults, such as arrears of rent, but once a lease is deemed surrendered, it cannot be terminated). In addition, a landlord will need to be aware that if the lease has been assigned, and the original tenant is not a party to the renewal (or some other agreement in which it agrees to remain liable throughout the renewal term), as a result of the new contract created by the renewal, the original tenant will not be liable under the new lease.

From a tenant's perspective, in the case of a renewal, personal rights (versus rights that run with the land) will not continue unless express language is used either in the lease or the renewal agreement to confirm that those personal rights will apply during the renewal term. Examples of personal rights in favour of a tenant that do not run with the land and would

otherwise be lost upon the renewal include signage rights, expansion rights and exclusive parking rights, just to list a few. There is no doubt that most tenants would be shocked to discover that these rights could be lost because of a distinction at law between renewals and extensions. It falls on the lawyer to ensure that proper documentation is prepared to protect these rights. Similarly, since it is not clear whether personal rights would survive a deemed surrender and regrant that arose in circumstances other than a renewal (i.e. in the case an expansion together with a merging of the original and new premises with a provision for a different rental rate as described above), it is the lawyer's responsibility to ensure that these rights expressly survive any potential deemed surrender and regrant.

For tenants, perhaps the biggest implication of a deemed surrender and regrant is the loss of priority over a mortgage that is registered on title to the property. If the tenant's lease initially had priority over the landlord's mortgagee and an amendment to that lease triggers a deemed surrender and regrant, the tenant will lose priority and become subordinate to the mortgagee. If the tenant's lawyer has not turned her/his mind to this issue, and in the absence of a non-disturbance agreement in favour of that tenant, the tenant will be at risk of losing possession of the premises if the landlord's lender exercises its rights upon a mortgage default by the landlord.

The effect of a deemed surrender and regrant also has implications for the landlord's mortgagee. The case of *Re: Goodyear Canada Inc. v Burnhamthorpe Square Inc.*<sup>22</sup> established the principle that in the absence of an agreement between the landlord's mortgagee and the tenant, those two parties do not have a direct relationship. Accordingly, if no documentation is in place and the holder of a mortgage having priority over a lease enforces its rights against a defaulting landlord and wishes to collect rent from the tenant, that tenant has the right to either

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<sup>22</sup> (1998), 41 OR (3d) 321 (Ont CA), varying (1997), 9 RPR (3d) 244 (ON Ct J (Gen Div), leave to appeal to SCC refused.

attorn to the mortgagee as requested or treat the lease as at end (subject to applicable notice periods). However, if the tenant's lease has priority over the mortgage, the situation is quite different: the prior lease will not be affected by the mortgage and the tenant does not have the right to terminate the lease early.

In the scenario where a tenant's lease has priority over a mortgage, the mortgagee will be safe in the knowledge that in the event of a default under the mortgage, that tenant will not be able to surrender its lease. However, if, following the registration of the mortgage, the tenant and landlord make amendments to the lease which result in a deemed surrender and regrant, the tenant's lease will then be subordinate to the mortgage. If the landlord's lender is not aware of this occurrence, it may not take the appropriate steps to protect itself (i.e. by obtaining an agreement by the tenant to attorn to the mortgagee) and may be surprised, after enforcing its rights under the mortgage, that the tenant (and rental stream) that it believed to be secure, is now entitled to walk away from its lease.

As with all claims that there has been a surrender by operation of law, the party alleging that there has been a deemed surrender and regrant will have the burden of establishing this claim. In any event, commercial leasing lawyers must be mindful that what may initially seem like a simple lease amendment may actually trigger the doctrine of deemed surrender and regrant. In these circumstances, we must be able to advise our clients accordingly.

### **Partial Surrenders**

As noted above, a tenant may surrender a portion of its premises, but it must surrender all of its rights and interest in the portion being surrendered. Under a lease, a tenant may have the right to downsize and surrender a portion of its premises or the landlord may have the right to

take back a portion of the tenant's space. In other cases, after the lease has been executed, the parties may agree (whether upon the request of the tenant or the landlord) that a portion of the premises will be surrendered by the tenant to the landlord. In either case, the parties will typically enter into an agreement to document the partial surrender and the parties' respective rights and obligations in connection with that surrender.

When drafting a lease provision that provides for a tenant's right to downsize, consider the following:

- Whether the tenant will have this right on only one occasion or whether it is a continuing right. With respect to the timing of the exercise of this right, it may be preferable for the landlord to insert a date by which the right must be exercised, failing which the right to downsize will cease. A clear notice period should be inserted so that both parties know when the right may be exercised by written notice. It should also be clear whether this right applies during the initial term only or any extension or renewal periods.
- The lease provision should identify the effective date of the partial surrender.
- Whether the right to downsize should be non-transferrable. Is the landlord agreeable to having certain transferees (such as "Permitted Transferees") exercise the right?
- Set out the amount of the early termination or surrender fee or the method by which that fee will be calculated.
- Clearly describe and identify the portion of the premises that may be surrendered. This can be done by identifying the space on a plan attached to the lease or by suite/unit number. If the right being granted pertains to a percentage of the area

leased by the tenant (i.e. the tenant may downsize the premises by a maximum of ten percent (10%) of the rentable area of the premises), the landlord will want to ensure that the space being surrendered is contiguous and located on the same floor (in cases where the tenant leases more than one floor). In addition, the clause should specify that the surrendered portion must be of a size and dimension and in a location that permits the landlord to lease that space to another tenant. The landlord will want to ensure that the space that it is left with is not awkwardly configured or difficult to lease (for example, a landlord would likely have difficulty reletting surrendered office space that had dimensions of five feet (5') by fifty feet (50')). The surrender portion of the premises must also have its own direct access from outside the building or proper access to and from the common areas of the building. The clause should require the tenant to deliver a plan showing the landlord the portion of the premises that it proposes to surrender.

- The lease provision should set out what items of work the tenant is responsible for, at its cost, in order to separate the premises from the surrendered space. If the landlord is responsible for any work, consider whether the tenant should be responsible for the landlord's cost. The following are some of the work items that should be addressed:
  - Work required to split the systems and facilities serving the premises (such as sprinklers, utilities and heating, ventilation and air-conditioning systems). If this work involves any base building, electrical or mechanical systems or facilities, often a landlord will prefer to take on the performance of this work, at the tenant's cost.

- Construction of demising walls, doors and exits to the common areas (including any additional egress doors that may be required in the premises or the surrendered premises under the Ontario Building Code,<sup>23</sup> particularly if those spaces are not equipped with automatic sprinkler systems).
- Repair of any damage caused by the work required to separate the premises from the surrendered portion.
- If required, the tenant should be responsible for obtaining any building permits, at its expense. The provision should also state that the work is to be completed in a good and workmanlike manner, in accordance with all applicable municipal codes (including fire and safety regulations) and requirements, applicable laws and any directives from the landlord and pursuant to plans and specifications that have been approved, in advance, by the landlord in writing and all other applicable provisions of the lease.
- Finally, the provision should make reference to the tenant's repair and restoration obligations set out in the lease. Alternatively, if these obligations differ for the surrendered portion, the provision should set out, in detail, what the tenant's repair and restoration obligations entail (including, removal of any trade fixtures, personal property, furniture, equipment (including cables, wiring and related devices), leasehold improvements and any special or non-standard improvements such as vaults, internal stairways, washrooms, showers and raised flooring).

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<sup>23</sup> O Reg 332/12, s 3.3.1.5.

When drafting the partial surrender agreement, or lease amending agreement, that gives effect to a partial surrender, the considerations set out above in this section should be addressed in that agreement. In addition, since the tenant is required to surrender its entire estate in the surrendered premises, the agreement should also include the previously suggested clauses for surrender agreements that are contained in the bullet points under the heading “Express Surrender” above.

## **Conclusion**

While astute landlords and tenants will likely have turned their minds to the practical aspects of a surrender (including the fees, work, removal and restoration, costs of work and removal/restoration and timing), commercial leasing lawyers must be well-versed in the law of surrenders of leases in order to properly advise their clients, achieve what was intended and, perhaps most importantly, avoid what was not intended.