NEWS Release

August 22, 2003

Is Accelerated Rent Slowing Down?

Many leases provide that upon the happening of certain events, (for example, the tenant's bankruptcy, insolvency, or default under the terms of the lease) the then current month's rent and the next three months' (accelerated) rent become immediately due. But how enforceable is this clause? Do courts actually uphold it?

The main difficulty with the enforceability of an accelerated rent clause is that the courts do not like penalty clauses. There is always a need to analyze whether the clause represents a "genuine pre-estimate of damages". If the clause does not meet this test, it will be regarded as a penalty, intended to deter certain behaviour. Courts will generally not enforce a penalty clause. This rule stems from the historical reluctance of courts to enforce provisions that are "draconian".

Determining whether a payment represents a true pre-estimate of damages or whether it is intended to be a penalty is not an easy task. In reaching a determination, the court must decide whether the payment is a "sum irrespective of the damage sustained" (in which case it is a penalty).

Some leases include a provision specifically stating that the accelerated rent is "a genuine pre-estimate of liquidated damages and not a penalty". While a court will not ignore such wording in the lease, the wording itself is not conclusive. The court will evaluate all of the surrounding circumstances, including the language of the lease, the intention of the parties and the landlord's other claims for damages for loss of future rent. Ultimately, the court will base its decision on what it considers to be fair.

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A recent case illustrates this point well. In *CREIT Management Ltd. v. The Great Canadian Bagel*, the landlord claimed against the tenant for arrears as well as damages arising from the tenant's breach of the lease, including six months' rent from the date of termination to the date the premises were relet and three months' accelerated rent (pursuant to the accelerated rent clause in the lease). The court awarded the landlord damages for an amount equalling the arrears of rent plus the rent for the six months that the premises were vacant; however, the Court held that the demand for three months' accelerated rent amounted to a penalty and was therefore not enforceable. The court looked to the fact that the landlord was awarded damages for six months of vacancy and determined that there was no basis upon which accelerated rent should be awarded.

On the other hand, in *365175 B.C. Ltd. v. Malamute Recreations Ltd.*, a landlord terminated the tenant's lease when the tenant failed to pay rent, and successfully sued for three months' accelerated rent. In that case, the court found that the accelerated rent was a bona fide pre-estimate of the landlord's damages.

"Why three months?", is a question worth asking. What if the stated period were six months, or a year, or the balance of the term? The landlord's preferred claim against its bankrupt tenant, under Section 136(1)(f) of the *Bankruptcy and Insolvency Act (the "BIA")*, includes three months' accelerated rent but only if the lease so provides. It is not clear whether, when landlords draft their standard lease forms, they reference three months solely to meet this requirement or because they believe that, generically, this represents a genuine pre-estimate of the damages that will flow from any default under the lease. It seems more likely that the landlords aim squarely at

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the *BIA* but overstate the acceleration to apply in cases of all defaults and not solely in the case of bankruptcy.

The accelerated rent provision motivates tenants to follow the provisions of the lease and sometimes it provides both parties with a rough estimate of the landlord's damages for the occurrence of default. The recent cases discussed in this article show that in certain situations, courts will limit its application - especially where applying it would not seem fair. Significantly, the inclusion of an accelerated rent clause will not preclude recovery for ordinary damages for a tenant's breach. Since there are circumstances in which the accelerated rent clause represents a fair and genuine pre-estimate of the landlord's reasonable damages (and as such the courts will uphold the clause in those circumstances), landlords are best advised to maintain its inclusion in standard form leases. As to the instances when lease negotiation will call for the removal of the clause, it is important to ensure that the clause is only removed in its application to other defaults but maintained for the default of bankruptcy.

Do REITs Pay Capital Tax?

Pursuant to the *Income Tax Act*, Canadian corporations pay capital tax based upon the corporation's taxable capital in excess of C$10 million. ("Taxable capital" basically means the debt and shareholders' equity figures reported on the liability side of a corporation's balance sheet.) Ontario also imposes a provincial capital tax, but only on corporations whose taxable capital is in excess of C$2.3 million. Some other provinces likewise levy capital tax.

A real estate investment trust (REIT) is not a corporation and is therefore not required to pay capital tax under the federal and provincial acts, yet many REIT lease forms nonetheless include capital taxes in the landlord's recoverable costs. Why do REITs bother mentioning capital tax if it is a largely irrelevant recovery?

One explanation is that if the REIT sells its property to a corporation, that corporation may want the option to recover its capital tax from the tenant. Without a capital tax provision, the property as a whole may be less saleable.

Another explanation may be that, in some situations, a REIT buys a property from a corporate landlord who was required to pay capital tax and established the recovery of that tax in its lease form, which becomes the REIT's lease form to administer after it acquires the property. Rather than depart from accepted past practice, the REIT continues to work with the historical lease form and preserve the recoverability of capital tax as a hedge against the future.

So while REITs, *per se*, do not pay capital tax, many of the vehicles through which they develop and acquire properties are in fact corporations. This will continue to make the capital tax recovery a standard component of any lease.

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