

A TENANT'S FEAR OF COMMITTING TO AN OPTION TO EXTEND A LEASE MAY BE COSTLY - A CASE COMMENT ON 2324702 ONTARIO INC. V. 1305 DUNDAS W INC., 2020 ONCA 353

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Introduction

It is settled law in Ontario that the renewal or extension provisions of a lease must be strictly complied with in order to be effective: *120 Adelaide Leaseholds Inc. v. Oxford Properties Canada Ltd.*, [1993] O.J. No. 2801 (C.A.) ("**120 Adelaide Leaseholds**"), and *Doria v. 66 Degrees Inc.* (2000), 30 R.P.R. (3d) 287 (Ont. S.C.).

The recent Ontario Court of Appeal decision in *2324702 Ontario Inc. v. 1305 Dundas W Inc.*, 2020 ONCA 353 is a good reminder for tenants that if it wishes to exercise its right to renew or extend the term of its commercial lease, it must do so in strict compliance with the renewal or extension provisions of the lease, or else it may risk losing such right with the resulting loss of its investment in the premises. If a tenant does fail to strictly comply with the renewal or extension provisions of the lease, and the landlord does not recognize the exercise, there may be an opportunity for the tenant to seek relief from the courts. However, in that case the tenant should ensure that its conduct has been reasonable and that it has made diligent efforts to comply with the terms of the Lease, as the courts will examine the conduct and reasonableness of the parties in determining whether or not such relief is warranted in the circumstances.

This Bulletin concludes with some key takeaways distilled from the lessons learned from this case, for a tenant wishing to exercise its right to renew or extend its lease.

Facts

2324702 Ontario Inc. (the "**Tenant**") leased a restaurant, lounge and event space in Toronto called 'Remix' from the predecessor of 1305 Dundas W Inc. (the "**Landlord**") pursuant to a lease and lease amending agreement (collectively the "**Lease**") with a term that expired on September 30, 2018. The Lease gave the Tenant a unilateral option to extend the Lease for a further five (5) years. Such option was required to be exercised by the Tenant by giving no less than nine (9) months' and no more than eleven (11) months' written notice to the Landlord prior to the expiry of the then current term. This meant that the written notice of extension had to be

given to the Landlord between November 1, 2017 and December 31, 2017.

The parties exchanged a number of emails with respect to the extension both before and during the notice period, including discussing and disputing the fair market rent value. When the Landlord requested the tenant to present its best offer, no best offer was ever presented in writing. The period to exercise concluded at the end of December 2017.

The Tenant failed to pay the February 2018 rent and the Landlord terminated the Lease.

The Tenant's Application

The Tenant commenced an application on February 21, 2018 for a declaration that the Lease had not been validly terminated, or alternatively, for relief from forfeiture re-instating the Lease if in fact it had been terminated. The Landlord brought a cross-application on July 21, 2018 for a declaration that the Lease was terminated. In the interim, the Tenant was permitted to remain in the premises by agreement of the parties and by order of the court, provided that the Tenant continued to pay rent, however, two rent cheques were paid late, one of which was returned for non-sufficient funds (NSF).

The application judge found that the Landlord had validly terminated the Lease for failure to pay rent in February 2018, but that the Tenant should be granted relief from forfeiture for its breach of the Lease for such failure. With the Lease still in effect, the two (2) issues before the application judge were: (1) whether the Tenant had validly exercised its option to extend the Lease either by proper exercise or by the Landlord waiving strict compliance; and if not, (2) whether the Tenant should be relieved from forfeiture for failing to validly extend the Lease.

(1) Did the Tenant validly exercise its option to extend (or had the Landlord waived strict compliance)?

The application judge found that the Tenant did not validly exercise the option to extend the Lease as it did not provide written notice of extension during the notice period. Among the emails exchanged, the phrase "exercise the option" was never used by the Tenant, nor did the Tenant trigger the arbitration process regarding the determination of fair market rent. Rather, the application judge found that the Tenant was looking to negotiate and agree on the rent as a condition of extension, which was not in conformity with the terms of the Lease, nor was it an unequivocal and clear exercise of the Tenant's option to extend.

The Tenant also argued that the Landlord had waived the need for strict compliance with the option requirements. The court application judge held that to find a waiver by a party of its legal rights there must be: (1) a full knowledge of the right by the party alleged to have waived such rights; and (2) an unequivocal and conscious intention to abandon those rights. This was not found to be the case. The application judge also rejected the argument that the Landlord was estopped by its silence or otherwise from relying on strict

compliance with the terms of the Lease.

(2) Should the Tenant be relieved from forfeiture for failing to validly extend the Lease?

Once he determined that the Tenant had not properly exercised its option to extend the Lease and that the Landlord had not waived the requirements, the application judge considered the Tenant's request that it be relieved from the harsh consequences of that through the exercise of the court's ability to grant relief from the forfeiture of rights. The application judge found that the Tenant's conduct was not reasonable, that it was hedging its bets, and that it had not made diligent efforts to comply with the terms of the lease, as required by *120 Adelaide Leaseholds* for a grant of relief from forfeiture. He also found that the Tenant was not unsophisticated regarding knowledge of its rights. Further, unlike in other cases, such as *Velouté Catering Inc. v. Bernardo*, 2016 ONSC 7281 ("Velouté"), which was the subject of a previous McMillan Bulletin entitled, *The-Timely-Exercise-of-Lease-Renewal-Rights*, the Landlord had not, by misrepresentation or conduct, led the Tenant to believe it had effectively renewed the Lease. (In the case of *Velouté*, a set of facts existed that warranted the court's exercise of its discretion to grant relief from forfeiture in relation to the tenant's failure to deliver the notice in time. Among other things, the court considered both parties' statements and conduct and in that case found that the landlord had, by misrepresentation or conduct, led the tenant to believe it had effectively renewed the lease.)

Finally, the application judge found that the Tenant's conduct did not warrant an award of equitable relief that would result in a five-year lease extension because the Tenant had missed paying rent on time three times, including under a court order.

On Appeal to the Ontario Court of Appeal

On appeal, the Tenant argued that the application judge erred by: (1) failing to find that the Landlord waived its right to require written notice of the Lease extension; and (2) failing to grant the Tenant relief from forfeiture for failure to deliver written notice of extension.

In upholding the overall findings of the application judge and dismissing the appeal, the Appeal Court held that:

(1) the Landlord did not waive its right to require strict compliance with the written notice provision of the extension option, nor did it do anything to indicate that it was abandoning its right to expect a written notice of extension within the notice period. Rather, it was the Tenant, which was not prepared to commit to the extension by actually exercising the option before it knew what the rent would be. The Tenant never sent its best offer. There were no further negotiations after the expiry of the option period and the Landlord was not required to inform the Tenant that it had not actually exercised its option to extend. The Tenant was hedging

and did not intend to exercise the option before the rent was agreed upon; and

(2) the application judge did not err by failing to grant relief from forfeiture. *The Commercial Tenancies Act*, R.S.O. 1990, c. L.7, allows the court to grant “such relief as [...] the court thinks fit”, having regard to all the circumstances, where a landlord seeks to enforce a right of re-entry or forfeiture following a tenant’s breach. In granting the discretionary and equitable remedy of a relief from forfeiture, a court is to consider the conduct of the applicant, the gravity of the applicant’s breaches of the lease, and the disparity between the value of the forfeited property and the damage caused by the breach. Although the failure to extend the Lease is not a breach of the Lease, the court may grant relief from forfeiture where a party seeks to extend the lease but has not complied with the formal requirements or preconditions for doing so. In such circumstances a precondition for the exercise of any such equitable discretion is that the tenant has made diligent efforts to comply with the terms of the lease which are unavailing through no default of his or her own. In the present case, equitable relief was not warranted because of the Tenant’s conduct: (1) the Tenant had not made diligent efforts to comply with the extension term, but instead hedged its bets by seeking to negotiate without committing to extend; and (2) Tenant failed to pay rent on time and provided the Landlord with a NSF cheque. Although the Tenant had a large investment in the premises which it stood to lose, this consequence is effectively a result of its own decisions regarding its conduct in relation to the Landlord.

Conclusion

This case underscores the importance of exercising a renewal or extension right in strict conformity with the terms and timelines provided in the lease document, and to ensure diligent efforts are made to comply with the terms of the lease. From the lessons learned from this case, here are some takeaways to consider for a tenant in exercising its right to renew or extend:

Exercising the Right to Renew or Extend:

- determine with certainty, well in advance of any renewal or extension notice period, whether or not the option or right to renew or extend will be exercised;
- carefully review the renewal or extension provision in the lease and make note of key dates and time periods, and do not rely on the landlord’s statements or conduct alone with respect to same;
- many tenants will want to settle the extension terms before coming to the last date to exercise. That can be prudent as it takes away the uncertainty of the rent negotiation (and being subject to arbitration if there is no agreement). But if a fully binding written agreement is not entered into prior to the last date for exercise, the tenant must exercise in accordance with the lease so that it does not lose the right;
- exercise the right to renew or extend the lease in strict conformity with the renewal or extension provisions in the lease document, typically by providing written notice of renewal or extension to the

landlord during the prescribed notice period and in the manner as set out in the lease;

- the written notice of renewal or extension must use unequivocal words expressing a clear exercise of the option or right to renew or extend, including the words “exercise the option to renew” or “exercise the right to extend”, as the case may be;
- do not rely on email exchanges with the landlord believing such communications indicate an understanding that the option to renew or extend has been exercised;

Seeking Relief from Forfeiture:

- ensure the tenant’s conduct is reasonable throughout and that the tenant makes diligent efforts to comply with the terms of the lease;
- reasonable conduct will almost always involves a tenant paying its rent on time and not supplying the landlord with NSF cheques;

Drafting the Lease:

- in the lease drafting phase, negotiate for a renewal or extension clause containing clear and reasonable timelines and that includes an arbitration clause with respect to the determination of rent;
- retain experienced legal counsel in the drafting of renewal or extension clauses in leases.

by William Rowlands and Kari Kim-Gallately

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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