

ENFORCING AN OFFER TO LEASE – ESSENTIAL ELEMENTS AND NO FUNDAMENTAL BREACH

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Introduction

In *Northridge Property Management Inc. v. Champion Products Corp.*, 2017 ONCA 249, two issues relating to agreements to lease commercial premises were considered: (1) when there is a binding agreement to lease, as opposed to an unenforceable “agreement to agree”; and (2) when the threshold of a fundamental breach by the landlord is achieved. These issues come up from time to time in commercial leasing and this decision provides useful guidance.

Facts

The landlord, Northridge Property Management Inc. (“Northridge”), and the tenant, Champion Products Corp. (“Champion”), entered into an agreement to lease providing for the use of the premises for Champion’s party supply business and sanitation supply business. This appeared to be a fairly typical agreement to lease which included an agreement by the parties to execute the formal lease, based on the landlord’s standard form of lease (which was attached as a schedule). The parties were obligated to act reasonably and in good faith in negotiating changes to non-financial lease terms to the form of lease.

The commencement date was November 1, 2011. The parties agreed to execute the lease by December 31, 2011 and, as a less typical term, agreed that if the terms were not agreed to by that date the matter would be resolved by binding arbitration.

The agreement to lease also obligated Northridge to complete certain renovations, which were outlined in a schedule to the agreement.

On November 1, 2011 Champion took possession of the premises. The lease had not been settled by that time and in fact was never settled and executed.

Following Champion taking possession, there were various discussions and exchanges of emails where Champion complained as to the state of the renovations and advised that it could not operate its business. With the exception of certain paving work, Northridge took the position that the work had been completed.

Sometime in late November Champion abandoned the premises.

Northridge commenced an action claiming damages for breach of the agreement to lease. Champion defended the action on two grounds: first, on the basis that the agreement was in fact a mere agreement to agree; and, in the alternative, that Northridge had fundamentally breached the agreement and, as a result, Champion was no longer bound to honour its terms.

Essential Elements of an Agreement to Lease

The trial judge held that there was a binding agreement to lease. The Court of Appeal agreed.

As with many commercial leasing situations, the transaction was a two-stage process, with an initial agreement to lease and a formal lease document contemplated later. In respect of such preliminary documents, the case law has indicated the distinction between a binding agreement and a mere and unenforceable agreement to agree as follows:

- i. where the parties intend that a preliminary agreement is binding on them and agree on all of the essential provisions to be incorporated into the subsequent formal document, they will have fulfilled the necessary elements for the formation of a contract. The fact that a formal written document to the same effect is to follow does not alter the binding validity of the original contract; and
- ii. on the other hand, where the original contract is incomplete because essential provisions that govern the relationship have not yet been settled, the contract is too general or uncertain to be valid, or is dependent on the subsequent formal contract, the preliminary agreement cannot constitute an enforceable contract.

The above principles apply to contracts in general. Leases have their own additional rules. It has been long-standing law that in order to create a valid lease (or agreement to lease) the document must:

- i. identify the parties (landlord and tenant);
- ii. provide a description of the premises to be leased;
- iii. provide a commencement date that is fixed or determinable (and not uncertain);
- iv. provide a term;
- v. set out the rent; and
- vi. set out all of the material terms of the contract that are not the usual matters incidental to the relationship of a landlord and tenant.

The trial judge also noted that the Court should not construe documents narrowly when determining whether they provide certainty over each of the required essential terms of a valid lease. Instead, agreements should be

construed broadly and fairly.

In applying all of these principles to the facts, the trial judge found there was a complete agreement and noted, in particular, as follows:

- i. all of the essential elements of a lease were present;
- ii. the agreement to lease contained an arbitration provision that provided a mechanism to resolve any disputes over the non-financial terms; and
- iii. the parties both conducted themselves as if there was an agreement between them.

The fact that Champion took possession was likely a key consideration in demonstrating the intent of the parties that they had a binding agreement. It is unlikely that a landlord would allow possession and that a tenant would take possession where they did not feel they had a binding agreement.

While the ability to settle the formal lease by arbitration was a factor, it was not stated as being determinative. Most agreements to lease do not contain such a provision.

In affirming the trial court's judgment, the Court of Appeal also noted that the parties were sophisticated corporate entities that discussed the terms of their bargain, reduced those terms to writing and signed an agreement reflecting those terms.

Fundamental Breach

Champion also argued that Northridge fundamentally breached the agreement to lease because the premises were zoned for warehouse use, and not retail. Champion further argued that Northridge's failure to complete the agreed renovations constituted an additional fundamental breach. A fundamental breach is often described as a breach "that deprives the innocent party of substantially the whole benefit of the contract" or alternatively as "a breach that goes to the root of the contract". If a fundamental breach is found, the non-breaching party is entitled to treat the contract as at an end. Here, Champion was attempting to use this principle to justify its abandonment of the premises.

Demonstrating the existence of a fundamental breach is a high threshold to meet. The trial judge in this case declined to find that Northridge had fundamentally breached the offer to lease and the Court of Appeal found that decision "unassailable".

In respect of Champion's zoning argument, the trial judge found that the zoning was suitable for Champion's business, which was chiefly a warehouse. The trial judge further held that the zoning also permitted a limited amount of retail. In reaching these findings, the trial judge observed that the first time Champion raised the zoning issue was in the defence to this action, implying that Champion did not view the zoning as a substantial

concern even when it left the premises.

In respect of the outstanding renovation work, the trial judge found that the deficiencies could be remedied for approximately \$25,000.00 – a relatively insignificant amount in relation to the value of the lease. The court commented that the most logical way for Champion to have resolved this issue would have been to complete the repairs itself and advance a claim against Northridge. Both the trial judge and the Court of Appeal indicated that the failure to perform any required repairs did not deprive Champion of essentially the whole benefit of the agreement to lease.

Conclusion

As the first step in what can be a long process, agreements to lease are often drafted and negotiated quickly. This decision is a reminder that agreements to lease often create valid and enforceable obligations between parties that can govern for a lengthy period of time. It is important for landlords and tenants to ensure that their interests are properly protected in such preliminary agreements to lease.

by William A. Rowlands

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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