

# Commercial Leases: Default Remedies and Exit Strategies for Landlords and Tenants

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CLARK WILSON

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## Anna Sekunova

- ❖ Partner in business litigation group, with a focus on real estate litigation and leasing disputes
- ❖ Practice in Lower Mainland for almost 20 years
- ❖ Acts for vendors and purchasers, and landlords and tenants
- ❖ Deals with a variety of disputes, from sophisticated leases to "napkin" agreements

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## Don MacKinnon

- ❖ Partner in commercial real estate group, with a focus on commercial leasing
- ❖ Practice in Lower Mainland for approximately 15 years
- ❖ Represents a range of commercial real estate interest holders, from municipalities, to public and private institutions on the landlord and tenant side
- ❖ Will work with clients to prepare standard lease templates, negotiate sticky lease terms or paper unique leasing or licensing agreements

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**Ric Hayward, Lower Mainland Bailiff Ltd.**

- ❖ Owner of Lower Mainland Bailiff Ltd.
- ❖ For over 30 years, successfully served Landlords and Property Managers helping them solve their commercial lease default issues
- ❖ Past executive of the BC Bailiff Association
- ❖ Presented seminars to Landlords, Property Managers, Lawyers and Trade Associations regarding commercial lease defaults

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**Current Trends in the Market**

- More attention on Security, including both prepaid rent provisions and the retention of security deposits
- Looking for stronger financial covenants with individual indemnifiers, not just guarantors
- No tenant rights to set-off or abatement or rents
- Seeking registered security interests against tenants and/or indemnifiers assets, or letters of credit
- Flexibility to relocate tenants or effect early termination rights

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**Early Termination Rights**

- Early Termination for Redevelopment
- Early Termination for the sale of the Property
- In the retail setting, early termination for failure to meet established goals where percentage rent is included
- Early Termination for default

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### Tenant Concessions and Requests

- Impose a reasonableness standard on the landlord when making decisions or administering the lease and imposing costs
- Greater certainty and stability in rent charges; capping CAM costs, limiting insurance costs and remove management or administrative costs
- Resisting going dark provisions, early termination rights and indemnities, or at least limiting their scope
- Seeking favourable assignment and sublease rights, including no requirement for consent on non-arms-length transfers
- Securing an exclusivity covenant for use, especially in the retail context
- Seeking right to register the lease and obtain financing on trade fixtures and inventory

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### Subordination and Lease Registration

- Public record and public disclosure, therefore need for a short form lease
- Subordination and postponement agreements to ensure landlord's lender remains primary lender in first priority
- Tenant's lender will require a non-disturbance agreement, which may be difficult to secure, especially from the Landlord's lender

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### Dealing With a Defaulting Tenant

- Decision involves legal and practical considerations
- Tenant's history and financial considerations (searches, due diligence)
- Look at your lease terms. How long left on the lease? What are your default rights? Does the tenant have any cure period?
- Current market conditions and possible replacement tenants
- What is the cost of replacing the tenant? (free TIs, etc.)
- Does the tenant have assets to recover from – rent arrears and damages?
- Is the tenant likely to dispute termination and litigate? (to be discussed later)

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Advice re tenant looking to get out of its lease

- Keep communications in writing
- Make all offers "without prejudice", ie off the record
- Seek a written proposal from tenant and ensure binding agreement
- Do not create waiver and estoppel arguments
- Consider an alternative solution
  - Partial surrender?
  - Shorter lease term?
  - Rent deferral or abatement?

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Issues in Enforcing Lease Against the Tenant

- Proper notices delivered to the tenant
- Formal communications better than informal emails
- On default, promptly deliver notice in writing in strict compliance with terms of the lease
- Set out the breach, action to be taken by the tenant and by when
- If required, allow a cure period before exercising remedies in lease (stronger case for termination with good paperwork)

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Enforcement Options Available to Landlords

When a tenant breaches the lease, the landlord has 4 options (*Highway Properties Ltd. v. Kelly Douglas & Co. Ltd.* (1972), 71 DLR (3d) 710):

1. Insist on performance of the lease and sue for arrears
2. Terminate the lease
3. Re-enter and take possession of the premises
4. Terminate the lease and seek damages for balance of term

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1st Option: Insist on Performance/Sue for Arrears

- Landlord may insist on tenant's performance of the lease (even if tenant abandons)
- Consider available security and litigation strategy (tenant's financial situation, available assets on premises)
- Landlord can seize (ie distraint) the tenant's property on leased premises for rent arrears
- Distraint (or distress) can be performed without notice to tenant, and without court involvement

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Distraint

- Can be levied only if rent is in arrears
- Landlord cannot terminate/change locks AND distraint = inconsistent remedies
- Hire a bailiff to follow all required procedures
  - Searches must be made to confirm that tenant's assets are not subject to other security interests with priority
  - Tenant often pays up rent and costs (including bailiff costs), or wants to settle/negotiate
  - **Bailiffs are a great source of information on distraint**

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Distraint (cont.)

- No forced entry, access must be gained by regular means
- Goods can be seized and removed, or can be left on premises if the tenant signs an agreement with bailiff to act as "bailee"
- Bailiff can conduct negotiations on landlord's behalf
  - If rent recovered, lease continues
  - If rent arrears remain after distraint, landlord may sue for deficiency and terminate lease

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Option 2: Termination of the Lease

- If breaches have not been remedied, consider termination
- Review the lease for specific procedure (not all breaches entitle the landlord to terminate)
- Do not do anything inconsistent with termination:
  - Do not distraint tenant's goods
  - Do not accept payment of overdue rent

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Option 2: Termination of the Lease (cont.)

- Provide written notice of termination to tenant
  - Include notice to vacate
  - Include notice to claim for rent arrears and damages to end of term
  - Usually lease provides for a right of termination and re-entry BUT consider if you want a court order confirming a right to terminate and an order of possession (under *Commercial Tenancy Act*)
    - o With questionable breaches
    - o Litigious tenant that will not vacate voluntarily

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Option 3: Take Possession of Premises

- Advise the tenant that the property will be re-leased "on the tenant's account" and re-take possession
  - Consider hiring a bailiff to re-take possession (particularly with difficult tenants)
  - Must allow original tenant to remove their possessions
- Can lease to another tenant for shorter term, apply rents received towards rent arrears owing by original tenant

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Option 4: Terminate and Sue for Rent Arrears and Damages

- Most common choice
- Landlords usually sue to recover:
  - Rent arrears
  - Damages for remaining rent payments to the end of term, less anything recovered from replacement tenant
  - Landlord's costs of a replacement lease (commissions, advertising costs, free TIs, etc.)
- Duty to mitigate applies (look for a replacement tenant asap)

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What are certain protections and enforcement options granted to tenants under the lease for when a landlord acts unreasonably or fails to perform?

- Claim for damages (unless limited in scope or waived)
- Specific performance of lease
- Termination rights (unlikely)
- Relief from Forfeiture

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Relief From Forfeiture – Remedy Available to Tenants on Termination

- Even with valid termination, a tenant may apply to the Court for relief from forfeiture of the lease (ie forgiveness of breach and reinstatement of the lease)
- Court application under s. 24 of *Law and Equity Act*
- Court will consider the loss to the tenant from termination vs. prejudice to the landlord from the tenant's breaches (usually granted in cases of non-persistent monetary breaches)
- Equitable remedy, court will consider all relevant conduct by both parties to determine "what is fair"

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### Relief from forfeiture (cont.)

- Only available once for breach of the same term
- In case tenant applies, important to keep detailed records of all breaches and communications between the parties
- More difficult for tenant to obtain if:
  - serious breaches of lease
  - bad faith conduct by the tenant
  - a new lease has been granted to a third party (ie other parties' interests are affected)

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### Tips and Take-Aways

- Obtain comprehensive information about the tenant beforehand
- Know your lease and follow its terms
- Keep written records of communications with tenants (consider one day they may be presented to the Court)
- When in doubt, seek prompt advice from professionals – lawyers or bailiffs

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## QUESTIONS?



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These materials are necessarily of a general nature and do not take into consideration any specific matter, client or fact pattern

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