

**HEY, THAT'S NO WAY TO SAY GOODBYE:
REMEDIES WHEN LANDLORDS UNREASONABLY WITHHOLD CONSENT**

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Commercial leases often contain provisions requiring a tenant to obtain the landlord's consent prior to undertaking or implementing a change. Leases often specify whether the required consent can or cannot be unreasonably, capriciously and/or arbitrarily withheld. The entitlement to arbitrarily withhold consent affords the landlord unfettered latitude when deciding whether it will or will not provide the requested consent. Consequently, if obtaining landlord's consent is a prerequisite before the tenant is able to undertake a certain step, tenants will usually negotiate the requirement that such consent not be unreasonably withheld.

If the consent relates to a request by the tenant to assign and/or sublease the lease, in Ontario the *Commercial Tenancies Act* specifies that unless a contrary intention is specified in the lease, the consent must not be unreasonably withheld. Section 23 (1) provides,

23. (1) In every lease made after the 1st day of September, 1911, containing a covenant, condition or agreement against assigning, underletting, or parting with the possession, or disposing of the land or property leased without licence or consent, such covenant, condition or agreement shall, unless the lease contains an express provision to the contrary, be deemed to be subject to a proviso to the effect that such licence or consent is not to be unreasonably withheld.

What then are a tenant's remedies if a landlord should unreasonably withhold its consent? Unless the parties can resolve the issue through mediation, negotiation, or arbitration, the tenant can either commence legal proceedings seeking declaratory relief and/or damages or, in exceptional circumstances, terminate the lease claiming the landlord's failure to provide the requested consent was a fundamental breach of the lease.

I - Declaratory Relief and/or Damages

Of the two remedies available, the most common and least risky remedy by far is the commencement of legal proceedings for a declaration that consent has been unreasonably

withheld along with an order permitting the tenant to assign or sublease its lease and/or for damages arising from the unreasonable withholding of consent.

Section 23(2) of the *Commercial Tenancies Act* specifies that where a landlord refuses to provide its consent, a tenant may bring an application requesting that the court make a determination of whether the refusal was reasonable. If the court finds that the landlord was acting unreasonably, it may make an order permitting the requested assignment or sub-lease. Section 23(2) provides:

Where the landlord refuses or neglects to give a licence or consent to an assignment or sub-lease, a judge of the Superior Court of Justice, upon the application of the tenant or of the assignee or sub-tenant, made according to the rules of court, may make an order determining whether or not the licence or consent is unreasonably withheld and, where the judge is of opinion that the licence or consent is unreasonably withheld, permitting the assignment or sub-lease to be made, and such order is the equivalent of the licence or consent of the landlord within the meaning of any covenant or condition requiring the same and such assignment or sub-lease is not a breach thereof.

The crucial question then becomes – “What constitutes unreasonable withholding of consent?” Below is a brief overview of the more salient considerations weighed by the court when determining if consent has been unreasonably withheld.

Although the courts have enumerated several factors to be considered when determining the reasonableness of the withheld consent, both objective and subjective evidence will be considered, and so each case will ultimately be decided on its specific facts, including the particular contractual provisions of the lease and the relationship between the parties.

The court in *1455202 Ontario Inc. v Welbow Holdings Ltd.* enumerated seven key principles to be considered and weighed when assessing whether the withholding of consent was reasonable.

- **(i) Burden of proof - Reasonableness:**

The party alleging that consent has been unreasonably withheld bears the burden of satisfying the court that the refusal to consent was unreasonable. Whether the court would have raised the same conclusion as the landlord or even whether a reasonable person might have given consent is not the test. Rather the question is whether a reasonable person could have withheld consent.

- **(ii) Information at the time of the refusal:**

In determining the reasonableness of a refusal, the court must consider the information available to the landlord and the reasons given by the landlord at the time of the refusal. Facts or reasons provided after the consent was refused and particularly those raised after legal proceedings were commenced, would be given significantly less weight than the reasons provided by the landlord when it initially refused consent. When considering information available to the landlord and the basis for the refusal, the landlord need only show that a reasonable person might have reached the same conclusion as the landlord.

- **(iii) Existing provisions in the lease:**

The question of reasonableness of the refusal to consent must be considered in light of the existing provisions of the lease that define and delimit the subject matter of the provision stipulating the requirement for consent.

- Although a landlord would not be entitled to require amendments to the terms of the lease that would provide it with more advantageous terms, it may be reasonable for a landlord to withhold consent if the assignment will diminish the value and cause landlords to suffer substantial economic loss.

- **(iv) Ulterior motives:**

The refusal of consent designed to obtain a collateral purpose or benefit wholly unconnected with the purpose of the provision or the bargain between the parties will be deemed unreasonable. The courts must give proper weight to this

consideration, regardless if other legitimate reasons were provided by the landlord justifying the refusal.

- **(v) Default of the assignee:**

The probability that the proposed assignee will default in its obligations under the lease may justify the withholding of consent. The finding of reasonableness will not be displaced even if the landlord would maintain the same legal rights of enforcement against the tenant should the assignee default under the lease.

- **(vi) Financial position of the assignee:**

Similar to the consideration of the likelihood that the proposed assignee may default in its obligation under the lease, the court will also give weight to the financial position or “personality” of the proposed assignee. The less financially stable a proposed assignee is the less likely the withholding of consent will be deemed unreasonable.

- **(vii) Factual determination:**

Whether one has acted reasonably must be determined based on the circumstances of each particular case including the commercial realities of the market place and the economic impact of an assignment on the landlord.

The court will consider what a reasonable person in the particular circumstances at hand (including the commercial realities of the parties and the contractual terms), would or would not have done to determine whether consent was unreasonably withheld. The court will be “slow” to substitute its judgment for the business judgment of the landlord.

Numerous cases have considered the above criteria - some finding in favour of tenants others in favour of landlords. Below is a synopsis of several cases:

Failure to Reply – Termination of the Lease

Zurich Canadian Holdings Ltd. v Questar Exploration Inc.

The tenant wrote to the landlord requesting consent to an assignment. The landlord did not reply to the request, but instead issued a notice of termination based upon a prior breach of the lease (which breach, the landlord claimed, arose as a result of the tenant’s failure to obtain the landlord’s consent for a previous amalgamation). The court found that the prior amalgamation did not require the landlord’s consent and the landlord was not entitled to terminate the lease. In

noting that the landlord's notice of termination was not an answer to the request for consent, the court found that the failure to reply to the request for consent was "an unreasonable refusal to consent".

Smith v 2249778 Ontario Inc.

In response to a request for consent to assign the lease, the landlord issued a notice of termination. The tenant thereafter withdrew its request to assign the lease, thereby reinstating the lease and commenced an application for a declaration that the landlord's failure to consent was unreasonable. The court found that the provisions of the lease entitled the landlord to elect to "cancel the lease in preference to the giving of such consent". An analysis of whether the landlord's refusal to provide consent was or was not reasonable was unnecessary. The tenant's application was dismissed.

Humford Developments Ltd. v 1026451 Alberta Ltd.

An explanation for its refusal to consent was not provided by the landlord until the court application was brought. The court noted that the failure to provide a reason at the time consent was refused was "reason enough to conclude that [the landlord had] unreasonably withheld its

consent".

Potential Loss of Income

Sundance Investment Corp. v Richfield Properties Ltd.

The tenant requested the landlord's consent to the assignment of its lease to Swiss Chalet. The terms of the lease contained the following caveat with respect to any assignment request "however it is understood and agreed that the withholding of consent by the Lessor shall not be construed or pleaded as being unreasonable if the other major tenant occupying the building objects to the nature of the business to be conducted by any sub-tenant or assignee". The "other

major tenant” in this case objected to the assignment citing concerns over traffic congestion which would significantly impact its sales. The reduction in sales by the “other major tenant” would have impacted the landlord as it was entitled to percentage rent. As such, the landlord refused to consent to the assignment. The Alberta Court of Appeal finding in favour of the landlord stated, “*If the test of reasonableness is what a reasonable landlord would do in the circumstances, would a reasonable landlord be expected to consent to an assignment of lease which might result in his direct loss of \$80,000.00 annual rental income? Surely not!*”

Suncor Energy Products Inc. v 2054889 Ontario Ltd.

The tenant, a gas station operator, requested the landlord’s consent prior to assigning its lease to another gas station. The landlord refused to consent alleging that the new tenant would decrease the financial value of the premises. The evidence submitted by the tenant, however showed the opposite: namely the new tenant would likely result in an economic benefit to the landlord. In finding for the tenant the court considered the commercial realities of the transaction and

concluded that a reasonable person would not have refused its consent to the assignment in these circumstances.

Speculative Concerns

Hudson's Bay Co. v OMERS Realty Corp.

The tenant, the Bay, entered into a real estate joint venture with a co-venturer and requested the landlord’s consent to assign/sublease the lease to the joint venture entity. The tenant argued that the assignee was not only the general partner of the joint venture but also one and the same as the existing tenant. The landlord alleged various concerns to justify its refusal to consent including the possibility that the limited partner may obtain control of the lease; that the assignment may trigger higher property tax; etc. The court determined that the particular transaction did not trigger the requirement to obtain the landlord’s consent, however if consent was required, the landlord’s purely speculative concerns did not justify the withholding of its consent.

Lease provisions Enumerating Grounds for Refusing Consent

1455202 Ontario Inc. v Welbow Holdings Ltd.

The tenant entered into an agreement with a potential purchaser of its restaurant business. The lease stated that the landlord could refuse to grant its consent if the proposed assignee:

- (a) did not have a history of successful business operations in the business to be conducted in the premises,
- (b) did not have a good credit rating and a substantial net worth; or
- (c) would be unable to finance the acquisition of its interest in the premises and its operations in the premises without a material risk of defaulting under the lease and in a manner that would enable the proposed assignee to carry on business successfully in the premises throughout the term.

The court found the three conditions listed in the lease were intended to be exhaustive and as such other grounds could not be raised by the landlord to justify the withholding of consent. The landlord's concerns regarding the purchaser's ability to carry on business successfully was a

reasonable and justified concern. The court determined that the tenant had not discharged the burden of proving that the landlord's refusal was unreasonable.

Change in Use*Zellers Inc. v Brad-Jay Investments Ltd.*

The tenant operated a Kmart Store in a plaza. Zellers Inc. purchased the business and closed the Kmart store. After an exhaustive search for a replacement tenant, Zellers Inc. requested the landlord's consent to alter the use of the premises to permit a sublease to a retail store selling clearance, close-out and liquidation merchandise. The landlord refused to provide its consent, listing various reasons including:

- it anticipated an "almost undeniable" negative financial impact if the proposed use were permitted;
- the proposed use would be "detrimental to the mall's image";
- the proposed new tenant would not be in the best interests of the landlord and the tenant mix;
- the proposed use would not be a high generator of traffic or of sales, but rather would be parasitic;
- there would be overlap with small independent tenants; and

- the month to month tenancy would not lead to nor promote any mall stability.

In finding in favour of the landlord the court stated:

It cannot be said that the landlord reached unreasonable conclusions. Before making its decision, its principal personally investigated various Close-Out King locations. The landlord sought advice from professionals, including its property manager, a real estate consultant, its lawyers and a second consultant. It did all of this before it made its decision. The landlord was put in a position of having to do its own due diligence, since the tenant was remarkably uncooperative in providing the information necessary for the landlord to make a reasoned decision. In my view, the landlord was entitled to rely on the advice it received. It cannot be said its actions were perverse; to the contrary, the landlord approached the issue in a

reasoned and reasonable way. The landlord's objective was to protect the character and integrity of the shopping centre as a viable economic enterprise. Its decision was made with that primary objective. While there were differing opinions on the likely effect of a Close-Out King in the mall, the opinions the landlord relied on are not clearly wrong. On the basis of its own investigations the landlord formed an honestly held belief that this tenant would detrimentally affect the mall. The landlord acted reasonably in coming to its conclusion. I therefore find its refusal to consent to a change of use was reasonable in all the circumstances.

Cooper & Lybrand Ltd. v William Schwartz Construction Co.

The sub-tenant proposed to operate a drugstore that would carry a wide variety of commodities in comparison to the existing drugstore. The landlord expressed concerns over the sub-tenant's operations that resembled a soft goods department which included the sale of towels, linens, babywear, and men's and ladies' clothing. The landlord refused consent and raised concerns that several of the existing tenants would suffer losses as a result of the competition they would face from the proposed sub-tenant. Although the tenant claimed the landlord had ulterior motives for refusing its consent, the court found that a reasonable person in the circumstance of the landlord would have withheld consent.

Ulterior Motive

Tradedge Inc. v Tri-Novo Group Inc.,

The tenant, who was suffering from financial difficulties, entered into a sale agreement conditional upon assignment of the lease. The landlord refused to consent unless several provisions of the lease were amended including an amendment to increase rent. The landlord reasoned that the increased rent was a reasonable offset to the proposed assignee's weak financial background. The Court of Appeal found in favour of the tenant, reversed the trial judge's decision, and determined that the landlord had unreasonably withheld its consent. The

evidence before the court included that there were two other tenants ready to lease the premises each willing to pay a premium for the lease.

Claim for Damages

In the majority of cases determining whether consent was unreasonably withheld, tenants seek a declaration that the landlord's consent was unreasonably withheld and order permitting the tenant to assign or sublease its lease. However, depending on the specific provisions of the lease and the circumstances of the case, it is also possible for the tenant to seek damages arising from the improper withholding of consent. In *Cudmore v Petro-Canada Inc.*, the British Columbia Supreme Court considered Petro-Canada's obligation to consent in the context of an assignment of a service station lease. The lessee was seeking an answer to the question, "Is the remedy of damages available to the Plaintiff (lessee) in an action against the Defendant (lessor) for unreasonable refusal of consent?" The court concluded that the phrase "which consent shall not be unreasonably withheld" should not be construed as a qualification of the tenant's covenant. Rather it is essentially a covenant on the part of the landlord not to "refuse his consent arbitrarily or unreasonably", which is subject to a remedy of damages if the covenant is not fulfilled.

Several Ontario cases have also suggested, albeit less directly than the court in *Cudmore*, that a tenant may have entitlement to claim damages in appropriate circumstances.

II - Fundamental Breach

In very limited circumstances, a tenant may allege that the landlord's refusal to provide its consent was a fundamental breach of the lease, thereby entitling it to either:

- i) treat the breach as a repudiation of the contract and end tenancy; or
- ii) to affirm the contract, fulfil the tenant's obligations, and sue for damages (subject to any limitations and releases in the lease or contract).

The courts have listed five factors to be considered when assessing whether a contractual breach is so "fundament" that the innocent party may treat the contract as an end.

1. The **ratio** of the party's obligations not performed to the party's obligations as a whole;
2. The **seriousness of the breach** to the innocent party;
3. The **likelihood of repetition** of such a breach;
4. The **seriousness of the consequences** of the breach; and
5. The **relationship** of the part of the obligation performed to the whole obligation.

A fundamental breach entitling a party to treat the contract as at an end "*is an exceptional remedy that is available only in circumstances where the entire foundation of the contract has been undermined, that is, when the very thing bargained for has not been provided.*" The test to be applied is "*whether the conduct of one party deprived the other party of substantially the whole benefit of the contract*".

Hence this remedy is likely available only in the most egregious cases of unreasonable withholding of consent. In *Jens Hans Investments Co v Bridger* the court held that the deliberate and repeated failures by the landlord to respond to requests for consent by the tenant were unreasonable and a fundamental breach of the lease. In reaching this finding the court followed the decision in *Lehndorff Canada Pension Properties Ltd. v Davis management Ltd.*

Recently the Supreme Court of Canada "laid to rest" the remedy of fundamental breach when dealing with exclusion clauses. Although not addressing all contractual circumstances, the

Supreme Court's decision is reflective of the court's general reluctance to utilize fundamental breach as a remedy following the breach of a contract.

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