Manitoba

Law Reform Commission

Commission de réforme du droit

COVENANTS IN COMMERCIAL TENANCIES

March 1995

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CHAPTER 1

INTRODUCTION

This is the second in a series of Reports on commercial tenancy law.[1] This Report will focus on several aspects of the law relating to covenants.

The law relating to covenants is difficult to understand. The difficulty is due in part to the technical terminology which necessarily accompanies a discussion of commercial tenancy law; words and phrases such as leases, covenants, privity of contract and estate, *in posse* and *in esse* are just a few of the terms which must be used. An understanding of this area of law is made more difficult by the fact that some of the principles which govern today originated in the English case law as long as five centuries ago; the judgments in these old English cases are not easy to read as they are full of words and phrases such as "shew", "doth" and "hath" and Latin words and phrases such as "concessi", "demisi" and "writs of warrantia chartae" which have disappeared from modern use.[2] In addition, the other governing principles, sections 3 to 8 of Manitoba's *Landlord and Tenant Act*,[3] defy understanding by all but the most learned real property lawyers; these provisions are full of technical jargon, some of which has a meaning in the landlord and tenant context which differs from its meaning in other contexts. Words such as "cessor", "reversionary estate", "avoidance" and "surrender" require a reader to keep a legal dictionary close at hand. To make matters worse, there is some overlap in the scope of these provisions, a phenomenon which is confusing and can probably be blamed on the fact that the provisions are based on legislative changes which were introduced in England and Ontario in a piecemeal fashion. All in all, we are faced with not a pretty picture.

A. BASIC CONCEPTS DEFINED

In an attempt to make this Report understandable both to ourselves and our readers, we will begin by defining several basic concepts of commercial tenancy law. We will also provide examples wherever we think this will be of benefit. In doing so, we will use the abbreviations L for landlord, T for tenant, S for subtenant, and L or T followed by a number to designate a person to whom a landlord or tenant has conveyed his or her lease interest. Thus, L will assign to L1 and L1 will assign to L2; T will assign to T1 and so on.

Lease. A lease is a contract between a person who owns real property (a landlord) and another person (a tenant), in which the landlord promises that the tenant can occupy and use the property for a period of time (a term) and the tenant usually promises to give the landlord something of value in exchange for this right, usually rent. In addition to being a contract, a lease is a conveyance of property; it conveys an estate or interest in the property from the

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[1]The first Report in the series is Manitoba Law Reform Commission, *Distress for Rent in Commercial Tenancies* (Report #81, 1994).

[2]*Spencer's Case* (1583), 5 Co. Rep. 16 a, 77 E.R. 72 (K.B.).

[3]*The Landlord and Tenant Act*, C.C.S.M. c. L70. Appendix B sets out these provisions and their origins.

landlord to the tenant. The landlord does not convey his or her entire ownership of the property to the tenant but rather retains the right to re-enter, control and use the property at the end of the term of the lease.[4]

Covenant. Every lease contains promises which are made by a landlord to a tenant and by a tenant to a landlord. For instance, a landlord may promise to keep in good repair a building which is leased to a tenant, while a tenant may promise to pay the property taxes levied by the municipality on the lease property. Promises such as these are called covenants.

There are several types of covenants. A positive covenant is a promise to do something: for example, a tenant's promise to pay the rent. A negative covenant is a promise not to do something; for example, a shopping mall tenant might promise not to compete with the other tenants in the mall. A covenant may relate to the property which is the subject of the lease or it may relate to other property. An example of the latter would be a landlord's promise not to start a competing business on other property that he or she owns. A covenant may pertain to something already in existence - for example, a building that is already constructed - or it may relate to something that is not yet in existence, such as a building which is yet to be built.

Most lease covenants are expressed in the lease. However, a few covenants are so inherent in the landlord and tenant relationship that their expression in the lease is not necessary because they are implied to be a part of every lease. An example of an implied covenant is the tenant's obligation to act in a tenant-like manner.[5]

Condition. A promise made by a landlord or tenant may be a condition rather than a covenant. The main difference between a covenant and a condition pertains to the consequences of a breach. If a tenant *covenants* to do something - for example, to repair the interior of the leased premises - and he or she does not do so, the landlord can sue the tenant for damages but cannot usually terminate the lease for this breach. On the other hand, if a lease is granted on the *condition* that the tenant repair the interior of the premises and the tenant does not comply, the landlord can end the lease.[6] In most other respects, covenants and conditions are treated in the same manner. To simplify matters, where the law applies equally to conditions and covenants, we will refer to both as "covenants"; however, we will indicate where a rule pertains only to one or the other.

Benefit or obligation of a covenant. A landlord or tenant who is entitled to the benefit of a lease covenant has the right to insist that the other party perform the promise made in the lease and can take legal action to enforce that right. A landlord or tenant who makes a promise in a lease is obligated to perform the lease covenant for the benefit of the other party to the lease.

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[4]The interest which a landlord retains in the property is called the reversion (sometimes called the reversionary estate), while the tenant's interest is called the leasehold interest (sometimes called the term). However, to avoid being overly technical, in this Report, we will refer to these as the landlord's interest in the lease property (or the landlord's lease interest) and the tenant's interest in the lease property (or the tenant's lease interest).

[5]See, *Wedd* v. *Porter*, [1916] 2 K.B. 91 at 101 and 102 (C.A.), in which Swinfen Eady L.J. referred to "covenants in law or implied covenants"; in that case, the tenant was found to have "the implied obligations to keep the buildings wind and water tight, and to use and cultivate the lands in a husbandlike manner according to the custom of the country, subject to the provisions of the Agricultural Holdings Act, 1908." See also, *In re King*, [1963] 1 Ch. 459 at 479 (C.A.), in which Lord Denning M.R. referred to "covenants implied in law"; *Yorkshire Trust Company* v. *Gunter Farms Ltd.* (1989), 40 B.C.L.R. (2d) 161 at 166 (C.A.), in which Southin J.A. stated that a covenant to pay rent ran with the reversion at common law; and *Thursby* v. *Plant* (1669), 1 Wms. Saund. 230 at 238, 85 E.R. 254 at 269 (K.B.), in which the parties agreed that the assignee of the landlord would be entitled to sue in debt for rent "because the common law hath annexed the rent to the reversion", and see the editor's note 4(a) in the same case: "the assignee of the lessor having no liability or right, except what is given him by 32 H. 8, his action is transitory by operation of the statute, except indeed in debt for rent, which he is entitled to, independent of all contract, by the mere relation in which he stands to the land." (at 240 (Wms. Saund.), 270 (E.R.)).

[6]*Doe dem. Willson* v. *Phillips* (1824), 2 Bing. 13, 130 E.R. 208 (C.P.).

Run with the land or reversion. A covenant is said to "run" when either the entitlement to benefit from it or the obligation to perform it passes to the person to whom the interest in the lease property is conveyed. If either the right to benefit from the covenant or the obligation to perform it passes to the person to whom the *tenant* assigns his or her lease interest, then the covenant is said to "run with the land". If either the right to benefit from the covenant or the obligation to perform it passes to the person to whom the *landlord* assigns his or her lease interest, the covenant is said to "run with the reversion". As noted on the preceding page, we will not use the abbreviated technical terms "land" and "reversion" but will refer to covenants as running with the landlord's interest in the lease property or the tenant's interest in the lease property.[7] The following examples demonstrate these concepts.

Example 1. L and T enter into a lease in which T promises that he will not assign the lease without L's consent. With L's consent, T assigns his interest to T1.

L-------T
|
T1

T1 becomes obligated by T's promise to obtain L's consent before assigning his interest. In other words, T's promise to obtain L's consent *runs* with the assignment by T of his lease interest to T1.

Example 2. L and T enter into a lease in which L promises to provide T with the quiet enjoyment of the lease property.[8] L assigns her interest to L1.

L-------T
|
L1

L1 becomes obligated to provide T with the quiet enjoyment of the property. L's promise to provide quiet enjoyment *runs* with the assignment of L's lease interest to L1.

Privity of contract. Individuals who enter into a contract together have a relationship which is called privity of contract.[9] Since every lease is a contract, every landlord and tenant who enter into a lease together are in privity of contract with one another. The privity of contract relationship between a landlord and tenant continues until the end of the term of the lease, even if the landlord or tenant or both assigns his or her interest in the lease property.[10] The following example demonstrates the concept of privity of contract.

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[7]*Merger Restaurants* v. *D.M.E. Foods Ltd.* (1990), 71 D.L.R. (4th) 356 (Man. C.A.) is a recent example of a Manitoba case in which the courts considered whether a particular covenant ran with the reversion so as to be binding upon the successor to the original landlord. The running of covenants will be considered in much greater detail in Chapter 2 of this Report.

[8]The covenant for quiet enjoyment confers upon a tenant the right to possession and enjoyment of the lease property.

[9]Certain consequences accompany the relationship of privity of contract. These will be discussed in detail in Chapter 2.

[10]*Avlor Investments Ltd.* v. *J.K. Children's Wear Inc.* (1991), 85 D.L.R. (4th) 239 (Ont. Div. Ct.); *Athan Holdings Ltd.* v. *Merchant Holdings Ltd.* (1982), 40 A.R. 199 (Q.B.).

Example. L and T enter into a 6 year lease. After 3 years, L assigns her interest to L1. Two years later, L2 agrees to purchase L1's lease interest on the condition that T enter into a contract with her regarding the rent and other matters pertaining to the lease property.[11] T contracts with L2.

L-------T (6 year term)
| (assignment 3 years later)
L1
| (assignment 2 years later)
L2

L and T are in privity of contract throughout the 6 year lease, even though L assigns her interest after 3 years. L1 and T are not in privity of contract because they did not enter into a contract with one another. However, L2 and T are in privity of contract because they entered into a contract with one another. Thus, after the assignment to L2, T is in privity of contract with both L and L2.

Option to renew and option to extend the term. Where a lease provides that the tenant has an option to *renew* the lease, if the tenant or tenant's assignee exercises the option, the lease ends and a new lease is created; when this happens, the privity of contract between the landlord and the tenant under the original lease ends.

However, if a lease provides that the tenant has the option simply to *extend* the term of the lease,[12] then if the tenant or tenant's assignee exercises the option, the original lease will continue until the end of the extended term and the privity of contract of the original landlord and tenant will also continue until the end of the extended term. The following examples demonstrate these principles.

Example 1. L and T enter into a 5 year lease which provides that "at the expiration of the term and upon T's written request, L will grant to T a renewal for an additional five-year term." One year later, T assigns her interest to T1. L consents to the assignment of the lease from T to T1 on the condition that T continue to be bound by the provisions of the lease. After the assignment, T1 notifies L of her intention to exercise the option to renew the lease for the additional five-year term. A year later, T1 defaults upon her rent obligations.

L-------T (5 year term)
| (assignment at 1 year)
T1 (renewal for 5 years)

The renewal leads to a new lease agreement, which puts an end to the privity of contract of L and T under the original lease, even though the new lease incorporates the provisions of the original lease.[13]

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[11]Entering into a direct contract, that is, being in privity of contract with another person, affords certain benefits as well as certain obligations. These will be discussed in detail in Chapter 2.

[12]In the alternative, the option may be contained in a supplemental agreement entered into between the landlord and tenant at a date after the lease is made with the intention that it become a part of the lease and have retrospective effect to the date of the lease: *Baker* v. *Merckel*, [1960] 1 Q.B. 657 (C.A.).

[13]*Avlor Investments Ltd.* v. *J.K. Children's Wear Inc.*, *supra* n. 10.

Example 2. L and T enter into a lease which provides that "the term shall be for 7 years, from and including the 1st day of October, 1994 to and including the 30th day of September, 2001." In November, 1995, L and T enter into an agreement which is endorsed on the lease and which provides that "the term granted by the lease shall be extended for a further four years at the option of the tenant and, if the tenant gives notice in writing to the landlord before October 1st, 2000 of the desire, the lease shall be read, construed and take effect as though the term granted by the lease was for a period of 11 years from October 1st, 1994." T assigns his interest to T1 in January, 1996 and T1 later exercises the option to extend.

L-------T
|
T1

L and T continue to be in privity of contract throughout the 11 year extended term, even though it was T1 and not T who exercised the option to extend the term.[14]

Privity of estate. Privity of estate is a relationship which exists between every landlord and tenant. The relationship continues for as long as the parties remain landlord and tenant and ends when either the landlord or tenant assigns his or her lease interest to another person. After an assignment, the assignee of the landlord or tenant steps into the shoes of the person who made the assignment; then, he or she is in privity of estate with the other party to the lease, whether that be the other original party who had entered into the lease or an assignee of that party. The following example demonstrates these principles.

Example. L and T enter into a 5 year lease. After one year, L assigns his interest in the lease property to L1.

L-------T (5 year term)
| (assignment 1 year later)
L1

L and T are in privity of contract because they entered into a contract together. They continue to be in privity of contract until the 5 year lease ends. For the first year, L and T are also in privity of estate because L is T's landlord. After the assignment, L and T are no longer in privity of estate because L is no longer T's landlord. Instead, when L1 becomes T's landlord, L1 and T are in privity of estate (L1 and T are not in privity of contract, since they did not contract with one another).

Partial Assignment. A landlord or tenant may assign his or her entire lease interest or only a part of it. An assignment of part of a lease interest could involve an assignment by a landlord or tenant of his or her interest in the entire property for a shorter period of time than the period during which the landlord or tenant holds the interest[15] or it might involve an assignment of only a geographical part of the landlord's or tenant's lease interest. A partial assignment might also combine these two: a landlord or tenant could assign a geographical portion of his or her lease interest for a period of time which is shorter than his or her interest.

The first of the following examples demonstrates a partial assignment by a landlord in which the landlord assigns for a period of time that is shorter than his or her interest; the second example demonstrates an assignment of a geographical part of a landlord's property.

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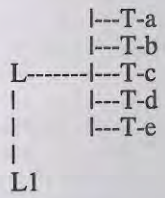
[14]*Baker* v. *Merckel*, *supra* n. 12.

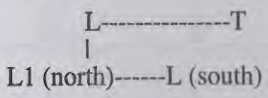
[15]A landlord can assign an interest of shorter or longer duration than the term of the existing lease.

Example 1. L owns a shopping mall which contains five retail outlets. L and T-a enter into a 5 year lease of one of these retail outlets. L enters into other leases with T-b, T-c, T-d and T-e for the remaining outlets for various periods of time ranging from 5 years to 8 years. L assigns his entire interest in the mall to L1 for 4 years.



For 4 years, L1 is the shopping mall's landlord. At the end of 4 years, L1's interest ends and L again becomes the mall's landlord.

Example 2. L and T enter into a 5 year lease of 10 acres of farmland. L assigns her interest in the north 5 acres to L1 and retains her interest in the south 5 acres.



L1 and L hold interests in different geographic parts of the farm property at the same time. L1 is the landlord of the north 5 acres; L is the landlord of the south 5 acres. Their landlord and tenant relationship with T ends at the end of the 5 year lease, at which time they are each entitled to enter into leases with respect to their individual lease interests.

Sublease. As just mentioned, a landlord or tenant can assign a lease interest for a shorter period than the length of their own interest. When a tenant conveys a lease interest for a shorter period of time than the term of the lease and retains the right to resume possession of the lease interest prior to the end of the term, he or she is said to sublet his or her interest;[16] the person who is conveyed the tenant's interest is called a subtenant. Subtenancies are treated differently than assignments because, although privity of estate exists between a landlord and an assignee of the tenant, privity of estate does not exist between a landlord and the tenant's subtenant.[17] Instead, when a tenant sublets his or her lease interest, the tenant who sublets his or her interest continues to be the tenant of the landlord in privity of estate with the landlord; at the same time, the tenant who sublets his or her interest becomes a landlord to the subtenant and privity of contract and estate exists between the tenant and his or her subtenant for the duration of the subtenancy. The following example demonstrates this principle.

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[16]*Jameson* v. *The London & Canadian Loan & Agency Co.* (1897), 27 S.C.R. 435, citing Preston, *Real Property* (2nd ed.) 377. The cited author also states that if the person who grants the sublease reserves for himself or herself a portion of the estate other than the last part of it, the conveyance will operate as an assignment, rather than a sublease.

[17]For a sublease to exist, a tenant must retain at least one day of the term of the lease.

Example. L and T enter into a 2 year lease. A month after entering into the lease, T assigns his interest in the lease property to T1. Six months later, T1 subleases his interest in the lease property to S for 1 year. T1 retains for himself the right to use the property (as a tenant) during the last 5 months of the lease.

L-------T (2 year term)
| (assignment 1 month later)
T1
| (sublease 6 months later, for 1 year)
S

T is in privity of contract and privity of estate with L before the assignment to T1. After T assigns his interest to T1, he continues to be in privity of contract with L but is no longer in privity of estate with L; T1 is in privity of estate with L. When T1 subleases his interest to S, T1 continues to be L's tenant and so remains in privity of estate with L. S and L are never in privity of contract or estate.

We hope that this introduction to some of the basic concepts of commercial tenancy law will make the discussion which follows easier to understand.

B. PRINCIPLES WHICH SHAPE OUR REPORT

A number of principles have shaped the decisions in our Report. They are:

1. The law should be rational, certain and simple.

2. Anachronisms should be abolished.

3. The law should be fair both to landlords and tenants.

4. The law should be changed only where a change is necessary; conversely, where there is no apparent need for reform, the present law should be retained.

Generally, we believe that the concepts of privity of contact amd privity of estate are so fundamental that they should be retained. We also believe that landlords and tenants should generally be free to make their leases as they see fit. However, several exceptions have been made to these concepts where we consider it necessary to achieve our stated objectives.

C. ORGANIZATION OF REPORT

In the Chapters which follow, we will examine the law which pertains to covenants with the goal of determining whether it should be reformed. We will begin in Chapter 2 with a discussion of the present law. This will be followed, in Chapter 3, by a discussion of the problems of the present law and options for reform, our recommendations for reform and a restatement of the principles which should govern the law. Chapter 4 sets out our proposal for amendments to *The Landlord and Tenant Act*, together with explanatory notes. In Chapter 5, we will provide a summary of our recommendations for reform and a restatement of the resulting legal principles. Finally, in Appendix A, we restate our draft legislation without commentary and, in Appendix B, we set out sections 3 to 8 of *The Landlord and Tenant Act* and their origins.

In the course of our discussion, we will focus on the present law relating to covenants. While the history of the present law is interesting, we believe that a discussion of this history is not

necessary in order to understand the present law and its associated problems and that its presentation would only complicate our discussion of this difficult subject. Readers who wish to have a historical perspective of the present law may consult one of the leading texts in this area.[18]

[18]For example, Rt. Hon. Sir R. Megarry and H.W.R. Wade, *The Law of Real Property* (5th ed., 1984); *Williams & Rhodes Canadian Law of Landlord and Tenant* (6th ed., 1988) (release 5, 1994); *Woodfall's Law of Landlord and Tenant*, vol. 1 (28th ed., 1978) (release 32, 1995).

CHAPTER 2

THE PRESENT LAW

In this Chapter, we will discuss the rights and obligations of the original landlord and tenant, the rules which govern whether a promise of a landlord or tenant obligates or benefits their assignees and the rights and obligations of the assignees.

A. OBLIGATIONS OF ORIGINAL LANDLORD AND TENANT

As mentioned in the preceding Chapter, a landlord and tenant who enter into a lease are in privity of contract with one another. A consequence of this relationship is that an original landlord and tenant are obligated to perform their respective covenants during the entire term of the lease,[1] even if one or both assigns his or her lease interest. Thus, an original landlord or tenant may be liable for a breach of covenant which he or she commits,[2] for a breach which he or she begins and which is continued by an assignee,[3] or even for a breach which is committed entirely by an assignee.[4]

> Example. L and T enter into a 3 year lease of a commercial building. T promises to pay the municipal taxes levied on the lease property. After a year, T assigns her lease interest to T1. T1 pays the taxes. At the end of the second year, T1 assigns her interest to T2. T2 does not pay the taxes.
>
> L-------T (3 year lease)
> | (assignment at year 1)
> T1
> | (assignment at year 2)
> T2

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[1] *Avlor Investments Ltd.* v. *J.K. Children's Wear Inc.* (1991), 85 D.L.R. (4th) 239 (Ont. Div. Ct.); *Athan Holdings Ltd.* v. *Merchant Holdings Ltd.* (1982), 40 A.R. 199 (Q.B.); *Kits Developments Ltd.* v. *Sanford Construction Ltd.* (1987), 5 A.C.W.S. (3d) 361 (B.C. Co. Ct.).

[2] *Churchwardens of St. Saviour's, Southwark* v. *Smith* (1762), 1 Black W. 351, 96 E.R. 195 (K.B.); and *Grescot* v. *Green* (1700), 1 Salk. 199, 91 E.R. 179 (K.B.) (tenant breach prior to assignment); *Duncliffe* v. *Caerfelin Properties Ltd.*, [1989] 27 E.G. 89 (Q.B.); *Wright* v. *Dean*, [1948] 1 Ch. 686 ; *Stuart* v. *Joy*, [1904] 1 K.B. 362 (C.A.); *Tarrabian* v. *Ferring*, [1917] 2 W.W.R. 381 (Alta. C.A.); and *Eccles* v. *Mills*, [1898] A.C. 360 (P.C.) (landlord breach prior to assignment).

[3] *Gooch* v. *Clutterbuck*, [1899] 2 Q.B. 148 (C.A.); Rt. Hon. Sir R. Megarry and H.W.R. Wade, *The Law of Real Property* (5th ed., 1984) 750 (breach commenced by original tenant and continued by the tenant's assignee); and *Eccles* v. *Mills*, *supra* n. 2 (breach is commenced by original landlord and continued by landlord's assignee).

[4] *Centrovincial Estates P.L.C.* v. *Bulk Storage Ltd.* (1983), 46 P. & C.R. 393 (Ch.); *Becton Dickinson U.K. Ltd.* v. *Zwebner*, [1989] 1 Q.B. 208; *In re Downer Enterprises Ltd.*, [1974] 1 W.L.R. 1460 (Ch.); *Baynton* v. *Morgan* (1888), 22 Q.B.D. 74 (C.A.); *Allied London Investments Ltd.* v. *Hambro Life Assurance plc.* (1985), 50 P. & C.R. 207 (C.A.) (tenant's assignee breaches covenant after assignment).

T and L are in privity of contract and, therefore, are obligated to perform their lease promises throughout the 3 year term of the lease. L can sue T for not paying the taxes, even though T no longer has a lease interest when T2 breaches the covenant.[5]

Moreover, the obligations of an original landlord and tenant can be greater than the promises which they made in the lease. The reason for this is that on an assignment, the assignee steps into the shoes of the original landlord or tenant and can do what the original party could have done with the assigned interest; this includes altering the lease by agreement with the remaining party to the lease.[6] The alterations bind the party who assigned the interest, even if that party did not know about or consent to the changes and the changes result in greater obligations.[7]

Example. L and T enter into a 4 year lease in which T promises to pay the property taxes. After 2 years, T assigns his interest to T1. A year later, T1 assigns his interest to T2. Without T's knowledge or consent, L and T2 agree to expand and renovate the facilities on the lease property. The property taxes increase as a consequence of the improvements to the property. T2 does not pay the property taxes.

L-------T (4 year lease)
| (assignment at year 2)
T1
| (assignment at year 3)
T2

As L is in privity of contract with T, L can sue T for T2's failure to pay the property taxes, including the increase in taxes.

The obligation of an original landlord and tenant is primary.[8] This means that, even after a tenant assigns his or her lease interest, the landlord can *first* seek performance of a covenant from the original tenant rather than the tenant's assignee.[9] Similarly, after an assignment by a landlord, the tenant can *first* seek performance from the original landlord rather than the landlord's assignee.

B. RIGHTS OF ORIGINAL LANDLORD AND TENANT

1. Rights of Original Tenant

A tenant who enters into a lease is entitled to sue the landlord for breaches which the landlord commits while the tenant holds his or her lease interest. The tenant retains the right to sue for these breaches even after he or she assigns the lease interest.[10] Thus, a tenant may

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[5]T can also sue T2 for the breach. The rights of L in relation to T2 will be discussed later.

[6]*Centrovincial Estates P.L.C.* v. *Bulk Storage Ltd.*, *supra* n. 4; *Baynton* v. *Morgan*, *supra* n. 4. Also see *Selous Street Properties Ltd.* v. *Oronel Fabrics Ltd.* (1984), 270 E.G. 643, cited by The Law Commission (Eng.), *Landlord and Tenant Law: Privity of Contract and Estate* (Report #174, 1988) 4.

[7]The obligation of the original parties to a lease differs from the obligations of a guarantor; the slightest change made to the obligation of the debtor by the creditor and debtor without the guarantor's consent releases the guarantor of his or her obligation: *Western Dominion Inv. Co. Ltd.* v. *MacMillan*, [1925] 2 D.L.R. 442 (Man. K.B.), aff'd [1925] 3 W.W.R. 456 (C.A.).

[8]This differs from the secondary liability of a guarantor, who is required to perform an obligation only when the person with primary responsibility defaults: *Warnford Investments Ltd.* v. *Duckworth*, [1979] 1 Ch. 127.

[9]The obligations of assignees will be discussed below.

[10]*City and Metropolitan Properties Ltd.* v. *Greycroft Ltd.*, [1987] 1 W.L.R. 1085 (Ch.).

commence a lawsuit against the landlord either before or after assigning his or her lease interest. However, a tenant will lose any right to sue for a debt due under the lease when he or she assigns the lease interest and registers the assignment under *The Real Property Act*.[11]

When a breach by a landlord continues after the original tenant assigns his or her interest, the original tenant can sue the landlord for the portion of the breach which is attributable to the period prior to the assignment.[12]

> Example. L and T enter into a 5 year lease. L promises to keep the lease premises in good repair. After the first year, L neglects her repair obligation and the roof leaks. Two years later, T assigns her lease interest to T1. L continues to neglect her repair obligation and the roof continues to leak.
>
> L-------T
> |
> T1
>
> T can sue L for the damages which occurred while T held the lease interest. T can commence the lawsuit either before or after she assigns her lease interest.

An original tenant is not entitled to sue the landlord for the portion of a continuing breach or for a breach which is committed in its entirety by the landlord after the tenant assigns the lease interest.[13]

> Example. L and T enter into a 4 year lease. L promises to pay the property taxes. T assigns to T1. After the assignment, L stops paying the taxes.
>
> L-------T
> |
> T1
>
> T is not entitled to sue L for the breach which L committed after T's assignment to T1.

2. Rights of Original Landlord

An original landlord is entitled to sue the tenant for a breach of covenant which the tenant commits while the landlord holds his or her lease interest. However, unlike a tenant, an original landlord does not retain the right to sue the tenant after the landlord assigns his or her lease interest for every breach committed prior to the assignment. Instead, after a landlord assigns his or her interest, he or she retains only the right to sue the tenant for rent and other debts which became due to him or her prior to the assignment, but does not retain any unexercised right to re-enter or obtain forfeiture of the lease property.[14]

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[11] *The Real Property Act*, C.C.S.M. c. R30, s. 101(3).

[12] *City and Metropolitan Properties Ltd.* v. *Greycroft Ltd.*, *supra* n. 10.

[13] *City and Metropolitan Properties Ltd.* v. *Greycroft Ltd.*, *supra* n. 10; Megarry and Wade, *supra* n. 3, at 743.

[14] *Sabray Investments Ltd.* v. *Hill*, [1978] 6 W.W.R. 721 (Man. Co. Ct.) interpreting sections 4 and 5 of Manitoba's *Landlord and Tenant Act*, C.C.S.M. c. L70. But see *In re King*, [1963] 1 Ch. 459 at 497 (C.A.) per Lord Diplock, who interpreted subsections 141(1) and (3) of England's *Law of Property Act, 1925*, 15 Geo. 5, c. 20 (similar to Manitoba's sections 4 and 5), as providing that, upon an assignment by the landlord, the original landlord loses all rights to sue for breaches of covenant by the tenant, even if the breach occurred entirely prior to the assignment:

> The expression "go with" must be intended to add something to the concept involved in the expression "annexed and incident to" and in my view connotes the transfer of the right to enforce the covenant from the assignor to the assignee with the consequent cessation of the right to the assignor to enforce the covenant against the tenant. Such remedies as the assignor was entitled to exercise in respect of existing breaches of covenant by the tenant become vested in, and

Example 1. In June, 1991, L and T enter into a 5 year lease in which T promises to pay the rent on a quarterly basis (in June, September, December and March). T makes the first 3 payments, but does not make the March, 1992 payment. T resumes paying the rent when the next payment is due, in June, 1992. In January, 1993, L assigns his lease interest to L1.

L-------T
|
L1

L is entitled to sue T for the rent arrears which were due in March 1992, and he retains this right even after he assigns his interest to L1.

Example 2. L and T enter into a 3 year lease in which they agree that L will have an immediate right of re-entry to the lease premises and the right to repossess the lease premises if T allows the premises to be used by persons who are not entitled to use the premises under the terms of the lease. T allows someone who is not entitled to do so to use the lease premises. L does not re-enter the lease property. Two weeks after the breach by T, L assigns his interest to L1.

L-------T
|
L1

Although L was entitled to re-enter the lease premises after T breached the lease obligation, after L's assignment to L1, L retains any right to sue for damages that he may have had prior to the assignment, but he does not retain the right to re-enter the lease premises.

Similarly, if a breach by a tenant causes damage which continues after the original landlord assigns his or her interest, the landlord does not retain the right to sue the tenant for the portion of the breach which is attributable to the period prior to the assignment.[15] Of course, an original landlord is not entitled to sue the tenant for the portion of a continuing breach which occurs after

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exercisable by, the assignee. This view of the meaning of subsection (1) is confirmed by subsection (3) which makes it clear that the assignee can exercise the remedies available under the terms of the lease or at common law in respect of breaches committed before the date of assignment of the reversion, for it is only in respect of such breaches that "the condition of re-entry or forfeiture" can have become enforceable before the assignee became entitled to the reversion.

Looked at purely as a matter of the meaning of the words used in section 141 of the Law of Property Act, 1925, I take the view that the effect of this section is that after the assignment of the reversion to a lease, the assignee alone is entitled to sue the tenant for breaches of covenants contained in the lease whether such breaches occurred before or after the date of the assignment of the reversion.

The majority decisions in *In re King*, as expressed above, were confirmed in *London and County (A. & D.) Ltd.* v. *Wilfred Sportsman Ltd.*, [1971] 1 Ch. 764 (C.A.). Also see *Arlesford Trading Co. Ltd.* v. *Servansingh*, [1971] 3 All E.R. 113 (C.A.) in which the Court held that the rule enunciated in the *London and County* case (that the assignee of the landlord can claim against the tenant arrears of rent accrued prior to the assignment, and can re-enter on the ground of the failure to have paid such arrears) applies when the tenant also has assigned his or her lease interest subsequent to the breach of covenant by the tenant and prior to the assignment by the landlord.

However, the correctness of this interpretation of the English law has been questioned by the Ontario Law Reform Commission because of the differences in the bases of the majority judgments and the vigorous dissent by Lord Denning in *In re King*: Ontario Law Reform Commission, *Landlord and Tenant Law* (Report, 1976) 27. In *In re King*, Lord Denning M.R. stated, at 480-481, that legislation had not changed the common law rule that the landlord alone rather than his or her assignee can sue a tenant for a breach of covenant which occurs entirely prior to an assignment and affects the original landlord's personal estate exclusively (for example, for the tenant's failure to pay rent) and that if a breach occurred while the landlord held his or her interest and continued to depreciate the property after the assignment so that the assignee was injured (as in the case of a failure to repair or reinstate), then the assignee could sue in respect of the whole damage.

[15] *In re King*, *supra* n. 14.

the landlord assigns the lease interest, nor for a breach which occurs entirely after the landlord assigns the interest.[16]

> Example. L and T enter into a 3 year lease. T promises L that she will keep the lease property in good repair during the term of the lease. After a year, T allows the lease property to fall into disrepair. Six months later, L assigns to L1. T continues to breach the covenant to maintain the lease property.
>
> L-------T
> |
> L1
>
> T's breach commences prior to and continues after L's assignment to L1. After the assignment to L1, L is no longer entitled to sue T for the breach.

C. RUNNING RULES

As mentioned in the preceding Chapter, when a landlord or tenant makes an assignment, the assignee becomes obligated to perform or entitled to benefit from a covenant made by the original landlord and tenant when the covenant *runs*.[17] The rules which govern whether a covenant runs are found in the common law[18] and *The Landlord and Tenant Act*.[19] In the following sections we will discuss these rules.

1. Touch and Concern

A covenant must *touch and concern* the land[20] in order to run when a tenant[21] or landlord[22] assigns a lease interest. A covenant touches and concerns the land when it affects the nature,

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[16]The landlord can sue the tenant with respect to these breaches where his or her assignee grants this right: see *In re King*, *supra* n. 14, at 488, where Lord Diplock stated that "the assignor and assignee can always agree that the benefit of the covenant shall not pass, in which case the assignor can still sue, if necessary, in the name of the assignee."

[17]*Merger Restaurants* v. *D.M.E. Foods Ltd.* (1990), 71 D.L.R. (4th) 356 (Man. C.A.).

[18]Equitable rules also govern the running of covenants; however, we are not concerned in this Report with the reform of these rules. The rules governing the running of covenants are set out in detail in the standard texts on real property: Megarry and Wade, *supra* n. 3, at 739-760; *Williams & Rhodes Canadian Law of Landlord and Tenant*, vol. 2 (6th ed., 1988) (release 5, 1994) 15-65 to 15-84; *Woodfall's Law of Landlord and Tenant*, vol. 1 (28th ed., 1978) (release 32, 1995) 11/24-11/36 (common law rules) and 11/36-11/42 (equity rules).

[19]*The Landlord and Tenant Act*, C.C.S.M. c. L70.

[20] A landlord and tenant can expressly provide in their lease that the benefit of a covenant will run to his or her assignee, even if it does not touch and concern the land: *Lamvid Inc.* v. *427654 Ontario Ltd.* (1985), 50 O.R. (2d) 782 (H.C.).

[21]*Spencer's Case* (1583), 5 Co. Rep. 16 a, 77 E.R. 72 (K.B.); *Mayor of Congleton* v. *Pattison* (1808), 10 East. 130, 103 E.R. 725 (K.B.); *Merger Restaurants* v. *D.M.E. Foods Ltd.*, *supra* n. 17. This is probably also true for registered leases, notwithstanding the general wording of subsection 101(2) of *The Real Property Act*, C.C.S.M. c. R30: see *Wilson* v. *Brightling* (1885), 4 N.Z.L.R. 4 at 8 (C.A.), in which Prendergast C.J. interpreted a similar New Zealand provision and stated that the legislators probably intended only to define the liability of the tenant's assignee rather than to extend it.

[22]The words "with reference to the subject matter of the lease" and "having reference to the subject matter thereof" in sections 7 and 4 respectively of *The Landlord and Tenant Act*, C.C.S.M. c. L70, have been described as a modern formulation of "touching and concerning the land": *Hua Chiao Commercial Bank Ltd.* v. *Chiaphua Industries Ltd.*, [1987] 1 A.C. 99 at 106-107 (PC). See also, *Thursby* v. *Plant* (1669), 1 Wms. Saund. 230, 85 E.R. 254 (K.B.); *Webb* v. *Russell* (1789), 3 T.R. 393, 100 E.R. 639 (K.B.); *Woodall* v. *Clifton*, [1905] 2 Ch. 257 (C.A.); and *Re Dollar Land Corp. Ltd. and Solomon*, [1963] 2 O.R. 269 (H.C.).

quality or value of the lease property or the mode of using or enjoying it or when it pertains to the subject matter of the lease.[23]

Covenants which touch and concern the land include promises to pay rent, repair buildings, insure against fire, improve the premises and use the property in a certain way.[24] Covenants which do not touch and concern the land include promises to pay taxes in respect of premises other than the lease premises and to build upon non-lease property, unless it is to be used in connection with the lease premises.[25]

Example 1. L and T enter into a lease of several buildings. In the lease, L promises to repair the buildings. L assigns his lease interest to L1, who later assigns his lease interest to L2.

L-------T
|
L1
|
L2

The promise to repair relates to the lease property. Therefore, the obligation to repair passes to L1 and then to L2 when L assigns to L1 and L1 assigns to L2.

Example 2. L and T enter into a lease. L promises in the lease that an adjoining property will only be used as a parking lot. T assigns her interest to T1 and T1 later assigns her interest to T2.

L-------T
|
T1
|
T2

L's promise does not touch and concern the lease property. Therefore, T1 and T2 are not entitled to benefit from L's promise to keep the lot as a parking space when T assigns to T1 and T1 assigns to T2.

2. Personal Service

A personal service covenant is a covenant which a landlord and tenant intend that one of them will personally perform.[26] They arise

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[23]*Mayor of Congleton* v. *Pattison*, *supra* n. 21. The test for whether a covenant touches and concerns the land has also been described in these ways: "the determining factor is whether the thing covenanted to be done immediately affects the land itself or the mode of occupying it, or not directly affecting the nature, quality or value of the thing demised nor the mode of occupying it, is a collateral covenant only which does not bind the assigns": *Rudd* v. *Manahan* (1913), 4 W.W.R. 350 at 352-3 (Alta. C.A.); "if the thing to be done is clearly for the benefit, support, and maintenance of the subject-matter demised": *Lyle* v. *Smith*, [1909] 2 Ir. R. 58 at 65 (K.B.); "The true distinction must, I think, be as between covenants to do things which will benefit the land, and therefore benefit the reversion (or to refrain from acts which will injuriously affect the land and the reversion), on the one hand, and covenants to pay money, or otherwise benefit the landlord's personal estate during the term, on the other.": *City of Vancouver* v. *Beaufort Properties Ltd.* (1982), 36 B.C.L.R. 83 at 90 (S.C.).

[24]*Williams & Rhodes Canadian Law of Landlord and Tenant*, *supra* n. 18, at 15-78 to 15-80.

[25]*Williams & Rhodes Canadian Law of Landlord and Tenant*, *supra* n. 18, at 15-82 to 15-83.

[26]*Mitchell* v. *McCauley* (1893), 20 O.A.R. 272 (C.A.); *Walsh* v. *Walper* (1901), 3 O.L.R. 158 (C.A.); *Lamvid Inc.* v. *427654 Ontario Ltd.*, *supra* n. 20; *Nylar Foods Ltd.* v. *Roman Catholic Episcopal Corp. of Prince Rupert* (1988), 8 A.C.W.S. (3rd) 446 (B.C.C.A.).

> . . . where a person contracts with another to do work or perform service, and it can be inferred that the person employed has been selected with reference to his individual skill, competency, or other personal qualification. . . .[27]

The obligation to perform a personal service covenant cannot be transferred to an assignee.[28] In other words, on an assignment by a landlord or tenant, an obligation of the original landlord or tenant to perform a personal service covenant will not pass to the assignee but will remain the obligation of the original party only.

3. *In Posse/In Esse*

A common law rule which affects whether or not an obligation of a tenant will become an obligation of the tenant's assignee centres around whether the obligation pertains to something which is in existence at the time of the lease and whether the lease specifies that the obligation is that of the tenant and *assignees*. The rule does not apply to obligations of landlords.

When an obligation of a tenant pertains to something that exists when the lease is made (*in esse*) and the other running rules are met, the tenant's assignee will be obligated by the covenant after an assignment, whether or not the original tenant specifies in the lease that he or she makes the promise on behalf of his or her assignees. An example of a covenant which pertains to a matter which is *in esse* is a covenant to repair a building which has already been built.[29]

However, when a tenant's promise to do something pertains to a matter which does not exist when the lease is made (*in posse*), the promise will not obligate the tenant's assignee (after an assignment by the tenant) unless the original tenant specified in the lease that he or she covenants on behalf of *his or her assignees*.[30] Covenants which pertain to matters that do not yet exist (*in posse*) include a covenant to pay for improvements to a building yet to be erected,[31] to build and re-build a house in the event that it is destroyed by fire[32] and to erect new buildings.[33]

D. RIGHTS AND OBLIGATIONS OF ASSIGNEES

Having reviewed the rules which govern whether a covenant runs, in the following sections we will discuss who is obligated or benefitted by covenants which run. We will begin by discussing assignments by tenants.

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[27]*British Waggon Co.* v. *Lea and Co.* (1880), 5 Q.B.D. 149 at 153.

[28]G.H. Treitel, *The Law of Contract* (8th ed., 1991) 596. But see, Ontario Law Reform Commission, *supra* n. 14, at 29, where the Commission stated that there is some confusion about whether personal service covenants are not assignable at all (so that any attempted assignment is void *ab initio*) or whether they are assignable, but the other remaining party need not accept performance by the assignee in lieu of performance by the assignor.

[29]See, *e.g.*, *Perry* v. *Bank of Upper Canada* (1866), 16 U.C.C.P. 404 and *Douglass* v. *Murphy* (1858), 16 U.C.Q.B. 113.

[30]*Spencer's Case*, *supra* n. 21; *Mayor of Congleton* v. *Pattison*, *supra* n. 21; *Emmett* v. *Quinn* (1882), 7 O.A.R. 306.

[31]*Hilliard* v. *Beck* (1889), 9 C.L.T. 90 (Ont. C.A.).

[32]*Emmett* v. *Quinn*, *supra* n. 30.

[33]*Doughty* v. *Bowman* (1848), 11 Q.B. 444, 116 E.R. 543 (Ex. D.); *McClary* v. *Jackson* (1887), 13 O.R. 310 (C.A.).

1. Assignment by Tenant

(a) Obligations of tenant's assignee

When a tenant assigns the lease interest, the assignee becomes obligated to perform those covenants which run. This does not mean that the assignee assumes responsibility for every breach (of those covenants which run) which is committed during the term of the lease; the tenant's assignee will not be responsible for a breach which is committed in its entirety by the original tenant prior to the assignment.[34]

However, if a breach is committed by the original tenant and continued by the tenant's assignee, the assignee will be liable for the entire breach including the portion of the breach which occurred before the assignment.[35]

> Example. T and L enter into a lease. T promises to repair the lease property. T does not repair the lease premises. T then assigns his lease interest to T1. T1 does not repair the lease premises.
>
> L-------T
> |
> T1
>
> T's promise to repair the property pertains to the lease property and, therefore, obligates T1 when T assigns to T1. Although the breach began while T held the lease interest, because it continued while T1 held the lease interest, T1 is liable to L for the entire breach, including the portion of the breach which occurred prior to the assignment.[36]

Of course, a tenant's assignee will also be liable for a breach of covenant which he or she commits while holding the lease interest.[37] A tenant's assignee remains obligated to perform the lease covenants (which run) only while he or she retains the interest in the lease; he or she will not be liable for breaches committed by a subsequent assignee.[38]

(b) Indemnity of original tenant

After an assignment, an original tenant and his or her assignee are both responsible for performing the tenant's lease covenants which run. However, the tenant's assignee is "ultimately" liable for breaches which he or she commits.[39] This means that if a landlord sues the original tenant and obtains damages for a breach committed by the tenant's assignee, the

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[34] *Churchwardens of St. Saviour's, Southwark* v. *Smith*, *supra* n. 2; and *Grescot* v. *Green*, *supra* n. 2. Although, in the *Grescot* case the judge indicated that, in effect, the tenant's assignee may be held liable for a breach committed in its entirety by the assignor-tenant, prior to the assignment, because the landlord can forfeit the tenancy if the breach is not remedied.

[35] *Granada Theatres Ltd.* v. *Freehold Investment (Leytonstone) Ltd.*, [1959] 1 Ch. 592 (C.A.); *Gooch* v. *Clutterbuck*, *supra* n. 3; Megarry and Wade, *supra* n. 3, at 750.

[36] However, as T is in privity of contract with L throughout the term of the lease, T is *also* liable to L for T's and T1's breach.

[37] *Centrovincial Estates P.L.C.* v. *Bulk Storage Ltd.*, *supra* n. 4; *Becton Dickinson U.K. Ltd.* v. *Zwebner*, *supra* n. 4; *In re Downer Enterprises Ltd.*, *supra* n. 4; *Baynton* v. *Morgan*, *supra* n. 4

[38] The original tenant and the tenant's assignee could agree that the assignee's liability continue after an assignment by the assignee.

[39] *Centrovincial Estates P.L.C.* v. *Bulk Storage Ltd.*, *supra* n. 4; *Becton Dickinson U.K. Ltd.* v. *Zwebner*, *supra* n. 4.

original tenant will be entitled to sue his or her assignee for indemnification.[40] The following example demonstrates.

> Example. L and T enter into a 4 year lease in which T promises to pay rent of $400 per month. After a year, T assigns to T1. T1 pays the rent as required but, after a few months, stops paying.
>
> L-------T
> |
> T1
>
> L can sue T or T1 for T1's non-payment of rent. If L sues T and T pays the rent that is owing, T can then seek indemnification from T1 for the same amount.

(c) Rights of tenant's assignee

When a tenant assigns his or her lease interest, the covenants made by the landlord (which run) will benefit the tenant's assignee. This does not mean that the tenant's assignee is entitled to sue the landlord for every breach of covenant (which runs) which is committed by the landlord during the term of the lease. For an assignment of a lease which is not registered, the common law governs: a tenant's assignee is not entitled to sue the landlord for a breach or portion of a breach which occurs prior to the assignment; only the original tenant can sue the landlord for such a breach.[41] However, for an assignment of a lease which is registered, subsection 101(3) of *The Real Property Act* provides that the right to sue and to recover debts or money due to the assignor passes to the assignee.[42]

However, if a landlord's breach begins before and continues after the tenant assigns the lease interest, the tenant's assignee will be entitled to sue the landlord for the portion of the breach which is attributable to the period after the assignment.[43] In addition, the tenant's assignee is entitled to sue the landlord for a breach which occurs in its entirety after the assignment to himself or herself, so long as the breach or the portion of a breach occurs while he or she holds the lease interest.[44]

(d) Partial assignment

When a tenant assigns only a parcel of the land or building covered by his or her lease interest rather than the entire lease interest, his or her assignee will be obligated or benefitted by the covenants in the lease to the extent that they comply with the running rules and they relate to the assigned parcel.[45] On the other hand, a covenant which relates only to the interest which the original tenant retains remains his or her obligation or benefit after the partial assignment.

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[40]*Moule* v. *Garrett* (1872), L.R. 7 Ex. 101.

[41]*City and Metropolitan Properties Ltd.* v. *Greycroft Ltd.*, *supra* n. 10.

[42]*The Real Property Act*, C.C.S.M. c. R30, s. 101(3).

[43]*City and Metropolitan Properties Ltd.* v. *Greycroft Ltd.*, *supra* n. 10. The Court also said that the original tenant is entitled to sue the landlord for the portion of the breach which occurred prior to the assignment.

[44]Megarry and Wade, *supra* n. 3, at 743.

[45]*Congham* v. *King* (1631), Cro. Car. 221, 79 E.R. 794 (K.B.), approved in *Stevenson* v. *Lambard* (1802), 2 East. 575, 102 E.R. 490 (K.B.); *Curtis* v. *Spitty* (1835), 1 Bing. (N.C.) 756, 131 E.R. 1309 (C.P.).

Example. T and L enter into a 6 year lease of 10 acres of farmland. T promises to repair the buildings on the south 5 acres. One year later, T assigns the south 5 acres to T1. T retains her interest in the north 5 acres. T1 does no repairs to the south 5 acres.

L----------T
|
T (north)---T1 (south)

T's promise to repair relates to the assigned parcel and, therefore, it obligates T while she holds the interest in the south 5 acres and obligates T1 after the assignment. L is entitled to sue T1 for the breach. L could also sue T for the breach as T and L are in privity of contract throughout the term; T would be able to seek indemnification from T1 should she be required to compensate L for T1's breach. T alone remains responsible for any promises which she made in respect to the north 5 acres which she retains.

(e) Subtenancy

As mentioned earlier, when a tenant assigns his or her lease interest, the tenant's assignee and the landlord are in privity of estate. However, where a tenant subleases his or her interest (that is, conveys the lease interest for a period shorter than the term of the lease) and retains a period prior to the end of term, privity of estate does not exist between a landlord and this assignee of the tenant.

The consequence of this is that neither the landlord nor the subtenant ordinarily can enforce the lease covenants against one another.[46]

Example 1. T and L enter into a 5 year lease. T promises to pay the rent. T conveys a lease interest to S for 4 years and retains the interest in the last year of the lease for himself. S does not pay the rent.

L-------T
|
S

S is not liable to L for the rent, as there is neither privity of contract nor estate between them. However, L can sue T when he does not receive the rent because of their privity of contract (and T can sue S).

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[46]*Lawler* v. *Sutherland* (1852), 9 U.C.Q.B.205 (C.A.); and *Mavrikos* v. *Island Savings Credit Union* (1991), 57 B.C.L.R. (2d) 241 at 248 (C.A.). At common law, parties had to be in privity of contract or estate in order to enforce their covenants against one another. This was sometimes a problem because landowners who sold part of their land to a purchaser who subsequently resold to another person were unable to control the future use of their property, as the second purchaser was not bound by an agreement concerning the use of the land entered into between the original owner and the first purchaser, as there was neither privity of contract nor estate between the subsequent purchaser and the original landowner. However, rules were developed by equity so that some covenants could benefit or obligate persons who held interests in land, whether or not privity of contract or estate existed. Initially, these rules were aimed at giving landowners some control over the future use of their property. In the leading case, *Tulk* v. *Moxhay* (1848), 2 Ph. 774 at 777-778, 41 E.R. 1143 at 1144 (Ch.), the Court enforced a covenant against a purchaser of land who bought with notice of the covenant, stating: "[T]he question is . . . whether a party shall be permitted to use the land in a manner inconsistent with the contract entered into by his vendor, and with notice of which he purchased." Later, the application of these rules was extended from their application only to freehold conveyancing, to lease covenants. For example, shopping centre tenants who have a common landlord are sometimes found to be entitled to enforce a non-competition covenant in their own lease or another tenant's lease against the other tenants, notwithstanding the lack of privity of contract or estate, due to a community of interest between the parties: *Rapos* v. *Rallis*,[1979] 1 A.C.W.S. 168 (Ont. H.C.); *London Drugs Ltd.* v. *Truscan Realty Ltd* (1988), 11 A.C.W.S. (3d) 41 (B.C.S.C.); and *Spike* v. *Rocca Group Ltd.* (1979), 23 Nfld. and P.E.I.R. 493 (P.E.I.S.C.). However, in *Cadillac Fairview Corp.* v. *Canada Safeway Ltd.* (1991), 27 A.C.W.S. (3d) 1238 (B.C.S.C.), a community of interest was not found.

Example 2. T and L enter into a 5 year lease. L promises to provide T with the quiet enjoyment of the property. T conveys a lease interest to S for 4 years and retains the interest in the last year of the lease for himself. After T's conveyance to S, L causes a disturbance on the property.

L-------T
|
S

S cannot sue L, as there is neither privity of contract nor estate between them. S can sue T and only T is entitled to sue L due to their privity of contract.

2. Assignment by Landlord

At common law, when a landlord assigned his or her lease interest, only covenants implied by law to be inherent in the landlord and tenant relationship, such as the tenant's obligation to act in a tenant-like manner, ran.[47] This meant that a landlord's assignee was neither obligated nor benefitted by most of the lease covenants entered into by the original landlord and tenant.[48] The legislation which has changed this common law rule will be discussed in the following sections.

(a) Rights of landlord's assignee

Section 4 of *The Landlord and Tenant Act*[49] provides that, when a landlord assigns his or her lease interest, the landlord's assignee is entitled to benefit from the tenant's covenants which are contained in the lease and touch and concern the lease interest. This does not mean that the landlord's assignee is entitled to sue for every breach of covenant (which runs) which is committed by the tenant during the term of the lease. Rather, section 4, read together with section 5 of *The Landlord and Tenant Act*,[50] provides that a landlord's assignee is entitled to sue for a breach which occurred before the assignment and which gave rise to a right of re-entry or forfeiture prior to the assignment, but is not entitled to sue for rental arrears which became due prior to the landlord's assignment.[51]

Example. L and T enter into a lease in 1991 in which T promises to build a house on the lease property according to certain specifications prior to June 30, 1992. According to the lease, L is entitled to re-enter the property if T breaches this covenant. On September 1, 1992, L assigns her lease interest to L1. At the time of the assignment, T had not built the house and L had not re-entered the lease premises.

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[47] *Wedd* v. *Porter*, [1916] 2 K.B. 91 at 101 (C.A.) per Swinfen Eady L.J., quoting *Platt on Covenants* (1829) 532: "Upon an implied covenant, however, an action at the suit of the assignee of the reversion was undoubtedly maintainable prior to the passing of . . . [the *Grantees of Reversions Act, 1540* (Eng.), 32 Henry 8, c. 34]"; *Yorkshire Trust Company* v. *Gunter Farms Ltd.* (1989), 40 B.C.L.R. (2d) 161 (C.A.).

[48] *Thursby* v. *Plant*, *supra* n. 22, at 270, editor's n. 4(a); *Rogers* v. *National Drug & Chemical Co.* (1911), 23 O.L.R. 234 (H.C.), aff'd 24 O.L.R. 486 (C.A.).

[49] *The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 4. The section probably applies to both written and oral leases: *Woodfall's Law of Landlord and Tenant*, *supra* n. 18, at 16/13.

[50] *The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 5.

[51] *Sabray Investments* v. *Hill*, *supra* n. 14. In comparison, subsection 141(3) of the *Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20, from which section 5 is derived, has been interpreted as providing that only a landlord's assignee can sue the tenant for a breach of covenant (for forfeiture, re-entry or damages) when the tenant's breach occurs in its entirety prior to the assignment by the landlord. See quote from *In re King*, *supra* n. 14.

L-------T
|
L1

Although L was entitled to re-enter the premises for T's breach of covenant prior to the assignment, after the assignment L is no longer entitled to do so. Instead, L1 becomes entitled to re-enter the lease premises for this breach.

The original landlord retains the right to sue the tenant for the accrued rental arrears.

Example. In June, 1991, L and T enter into a 5 year lease in which T promises to pay the rent 4 times per year (in June, September, December, March). T makes the first 3 payments, but does not make the March, 1992 payment. T resumes paying the rent when the next payment is due, in June, 1992. In January, 1993, L assigns her lease interest to L1.

L-------T
|
L1

The payment of rent which was due in June, 1992 and never paid became due prior to the assignment by L to L1. Only L can sue T for the rental arrears.

In addition, if a breach by a tenant continues after the landlord assigns his or her interest, the landlord's assignee will be entitled to sue for the entire breach, including the portion of the breach which occurred before the assignment.[52]

Example. L and T enter into a 3 year lease. T promises that she will keep the lease property in good repair during the term of the lease. T keeps her promise for about a year. After a year, T allows the lease property to fall into disrepair. Eighteen months into the lease, L assigns her interest in the lease property to L1. T continues to do nothing to maintain the lease property.

L-------T
| (assignment at 18 months)
L1

T's breach occurs prior to and continues after the assignment. L1 is entitled to sue T for the entire breach; L cannot sue T for the breach.

If a tenant breaches a covenant after the landlord assigns his or her interest, then the landlord's assignee alone will be entitled to sue the tenant for the breach.[53]

Example. L and T enter into a lease in which T covenants to keep the lease property in good repair. L assigns her interest to L1, who subsequently assigns her interest to L2. Subsequently, T assigns her interest to T1, who later assigns her interest to T2. While L2 and T2 are landlord and tenant, T2 breaches the covenant originally made by T to keep the property in good repair.

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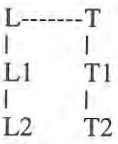
[52]*Sabray Investments* v. *Hill*, *supra* n. 14. Also see, *Rickett* v. *Green*, [1910] 1 K.B. 253, interpreting subsection 10(1) of the *Conveyancing and Law of Property Act, 1881* (U.K.), 44 & 45 Vict., c. 41.

[53]*The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 4; *In re King*, *supra* n. 14. See earlier discussion at pp. 12-13 of this Report.



Only L2 can sue T2 for this breach of covenant.[54]

According to section 3 of *The Landlord and Tenant Act*, the landlord's assignee has the same remedies available to him or her as would have been available to the original landlord had he or she been entitled to sue the tenant for a breach of covenant.[55]

(b) Obligations of landlord's assignee

Section 7 of *The Landlord and Tenant Act*[56] provides that when a landlord assigns his or her interest, the landlord's assignee becomes obligated to perform the landlord's covenants which run. An original landlord will be responsible for a breach which occurs *in its entirety* prior to an assignment.[57] However, when a breach is started by the original landlord but continued by his or her assignee, the landlord's assignee will be liable for the entire breach, including that portion of the breach which was committed prior to the assignment.[58]

In addition, a landlord's assignee will be liable for a breach which he or she commits while holding the lease interest. However, a landlord's assignee will not be liable for a breach of covenant which is committed by a subsequent assignee; the subsequent assignee will be responsible for breaches which are committed while he or she holds the lease interest.[59]

Unlike section 4, section 7 is not limited in its application to covenants which are contained in a lease. It is possible, therefore, that a landlord's assignee may be obligated by promises made by the landlord which are contained in a document other than the lease.[60] The following examples demonstrate the effect of the differences in wording between sections 7 and 4.

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[54]According to one case, L2 could also sue T for this breach even though there is neither privity of contract nor privity of estate between L2 and T: *Arlesford Trading Co. Ltd.* v. *Servansingh*, *supra* n. 14.

[55]*The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 3. The English legislation from which section 3 is derived was enacted for the reason that

> On the dissolution of the monasteries in England it was found that persons, including the Crown, into whose hands the forfeited leases of monastic lands had come, were without remedy for breaches of covenant. To obviate this difficulty, the Grantees of Reversions Act, 1540 (Eng.), c. 34, was passed. . . . :

Williams & Rhodes Canadian Law of Landlord and Tenant, *supra* n. 18, at 15-65.

[56]*The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 7.

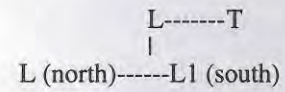
[57]*Duncliffe* v. *Caerfelin Properties Ltd.*, *supra* n. 2; *Wright* v. *Dean*, *supra* n. 2; *Stuart* v. *Joy*, *supra* n. 2; *Tarrabian* v. *Ferring*, *supra* n. 2; *Eccles* v. *Mills*, *supra* n. 2.

[58]*Duncliffe* v. *Caerfelin Properties Ltd.*, *supra* n. 2; *Eccles* v. *Mills*, *supra* n. 2.

[59]An exception to this is that the landlord's assignee could continue to remain liable after a subsequent assignment, if he or she enters into an indemnity agreement with his or her assignee.

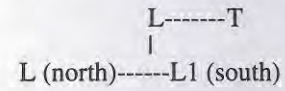
[60]See *Weg Motors Ltd.* v. *Hales*, [1962] 1 Ch. 49 (C.A.), in which the Court interpreted the equivalent sections to Manitoba's sections 4 and 7 in this way. Also see, *789247 Ontario Inc.* v. *215 Piccadilly Properties Inc.* (1991), 20 R.P.R. (2d) 294 (Ont. Div. Ct.), which dealt with a collateral agreement to a lease but which was not decided on the basis of Ontario's equivalent to Manitoba's section 7. In fact, the case did not mention the section. The Court held that the landlord's assignee of the landlord could not deny his obligation under the side agreement, but its decision was based on the principle of estoppel. The landlord was held to be bound by the express promise made by the original landlord even though the promise was not contained in the lease. The Ontario Law Reform Commission also interpreted their equivalent section in this manner: Ontario Law Reform Commission, *supra* n. 14, at 26-27.

Example 1. L leases 10 acres of land to T for 8 years. Although not mentioned in the lease document, L promises in a letter to T that he will repair the fences on the lease property. L assigns the south 5 acres to L1 and retains his interest in the north 5 acres. L forgets to tell L1 about the promise to repair the fences. Although the fences on the south 5 acres need repair, L1 does not repair them.



L1 may be found to be responsible for the repair of the fences on the south 5 acres, even though L's promise was not mentioned in the lease and L1 was unaware of L's promise when he obtained the assignment of the lease interest.

Example 2. L leases 10 acres of land to T for 8 years. T promises, in a document other than the lease, to use the property only for raising horses. L assigns the south 5 acres of land to L1. L retains his interest in the north 5 acres. T starts a pig farming operation on both the north and south 5 acres of land.



Since T's promise regarding the use of the property was not contained in the lease, T will not be liable to L1 for not using the south 5 acres as he had promised. L is entitled to sue T for the breach insofar as it involves the north 5 acres of land in which L continues to hold a lease interest, because L and T are in privity of contract.

Section 6 of *The Landlord and Tenant Act*[61] provides that, when a landlord's assignee breaches a covenant, the tenant is entitled to sue him or her and obtain the same remedies as if he or she were suing the original landlord for a similar breach.

(c) Indemnity of original landlord

After an assignment, both an original landlord and his or her assignee are responsible for performing the lease covenants which run. However, if an original landlord is called upon to pay damages for a breach which is committed by his or her assignee, the landlord can claim indemnity from that assignee.

(d) Partial assignment

At common law, when a landlord assigned only a part of his or her lease interest, whether for a time shorter than his or her own interest or only a geographical part of it, he or she could sue the tenant for a breach of covenant which pertained to the retained or assigned interest, but his or her assignee could not.[62] This common law rule was changed by statute.[63]

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[61] *The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 6.

[62] *Mayor of Swansea* v. *Thomas* (1882), 10 Q.B.D. 48.

[63] *Grantees of Reversion Act, 1540* (U.K.), 32 Henry 8, c. 34, provided that covenants which relate to the interest in a lease which is assigned by a landlord benefit or obligate the landlord's assignee even when the landlord assigns only a parcel of his or her lease interest: *Twynam* v. *Pickard* (1818), 2 B. & Ald. 105 at 109-111, 106 E.R. 305 at 307 (K.B.).

Section 4 of *The Landlord and Tenant Act* provides that when a promise made by a tenant relates to the assigned interest, it will benefit the landlord's assignee after the assignment, even though the landlord's interest is divided. Similarly, section 7 provides that an obligation of a landlord that relates to the assigned interest will obligate his or her assignee, despite the division of the landlord's lease interest.

> Example. T and L enter into a lease for 10 years. In the lease, L promises that during the second year of the lease, she will improve the premises by installing central air conditioning. Soon after the lease is executed, L assigns her interest for 2 years to L1. L1 does not install the air conditioning.
>
> L-------T
> | (assignment at year 2)
> L1
>
> L1 will be liable for breaching L's promise, even though L1 was assigned only a portion of L's lease interest.

Another common law rule was that conditions (as opposed to covenants) ended when a landlord's lease interest was divided by assignment into more than one parcel.[64] However, now, subsection 8(1) of *The Landlord and Tenant Act*[65] provides that an obligation in a lease which entitles the landlord to re-enter for a breach by the tenant can be apportioned when the landlord's lease interest is divided. Thus, after a landlord assigns a part of his or her lease interest, the landlord and the assignee will each be entitled to enforce the tenant's obligations which relate to their respective interests, even when a breach entitles the landlord or the assignee to re-enter the lease property.

> Example 1. L and T enter into a 15 year lease of two buildings. T promises to keep the buildings in good repair. L has the right to re-enter the lease premises for a breach of this obligation. L assigns his interest in the south building to L1 and retains his interest in the north building. T does not keep the buildings in good repair.
>
> L------ T
> |
> L (north)------L1 (south)
>
> L is entitled to re-enter the premises for the breach in respect to the north building, while L1 can do the same with respect to the south building. L cannot sue T for T's breach in respect to the south building.

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[64]The earliest legislative reforms did not change this common law rule. The *Grantees of Reversions Act, 1540* (Eng.) 32 Henry 8, c. 34, altered the common law rule respecting the running of both covenants and conditions when a landlord assigned his *entire* lease interest for a period of time. However, generally, it applied only to covenants, not conditions, when a landlord assigned only a parcel of his or her lease interest; the 1540 legislation did not alter the curious common law rule that conditions could not be divided between more than one parcel of land: *Dumpor's Case* (1603), 4 Co. Rep. 119 b, 76 E.R. 1110 (K.B.); and see, Megarry and Wade, *supra* n. 3, at 754-755. However, this distinction between covenants and conditions was eliminated by later legislation: *Law of Property Amendment Act, 1859* (U.K.) 22 & 23 Vict., c. 35, s. 3; *Conveyancing and Law of Property Act, 1881* (U.K.), 44 & 45 Vict., c. 41, s. 12(1); *Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20, s. 140(1).

[65]*The Landlord and Tenant Act*, C.C.S.M. c. L70, s. 8(1).

Example 2. T and L enter into a 10 year lease. In the lease, T promises to use the property only for a daycare. The lease specifies that L can re-enter for a breach of this obligation. Soon afterwards, L assigns a lease interest for a 2 year period to L1. While L1 is the landlord, T converts the space to an adult fitness centre.

L-------T
| (2 years)
L1

L1 is entitled to re-entry for T's breach of promise regarding the use of the property.

E. CONCLUSION

Having reviewed the present law respecting covenants in commercial tenancies, we will proceed, in the next Chapter, to discuss the problems of the current law, options for reform and our recommendations for the improvement of the law.

CHAPTER 3

REFORM

As we stated at the beginning of this Report, commercial tenancy law is incredibly difficult to understand. It is probable that only a very small number of individuals who are affected by this law actually have a good understanding of it. A quick glance at the ancient, arcane and verbose wording of sections 3 to 8 of *The Landlord and Tenant Act* - the foundation of the law respecting covenants in commercial tenancies - provides proof of its near incomprehensibility. To begin with, the wording of these sections is based on English provisions, some of which date back to the sixteenth century. In addition, the provisions are poorly organized; this results from the fact that the English provisions from which Manitoba's provisions are derived were enacted a few at a time in response to the need to overturn various common law rules.

It is also not helpful to an understanding of this area of law that the courts are not always consistent in their reasons for judgment. For instance, while the courts generally rely on the principles of privity of contract and estate in determining who can sue and who is liable for a breach of covenant, sometimes the courts ignore these principles.[1]

The difficulty in ascertaining the law in this area also stems from the inconsistency in the rules which pertain to assignments of landlords and tenants. For example, as discussed earlier, different rules govern the rights of assignees of landlords and tenants to sue for breaches which occur prior to and continue after an assignment: an assignee of a landlord is entitled to sue for the entire breach when the tenant's breach continues after the landlord's assignment, while an assignee of a tenant is entitled to sue only for the portion of the breach which is attributable to the period after the assignment. There is no logical reason for different treatment to be afforded to the assignees of tenants and landlords in this situation; the different rules only serve to complicate the law.

We believe that the essential starting point of reform of the law of covenants in commercial tenancies is to rewrite sections 3 to 8 of *The Landlord and Tenant Act* in more modern and understandable language. We recognize that the law of covenants is, by its very nature, complex and that plain language may be difficult to achieve. Nonetheless, we believe there is ample scope for improvement.

RECOMMENDATION 1

The provisions in The Landlord and Tenant Act which pertain to covenants should be rewritten in modern, clear and simple language.

However, it is not enough to recast the existing state of the law in more modern language. The preceding Chapter made it apparent that there are a number of inconsistencies and areas of

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[1] *Arlesford Trading Co. Ltd.* v. *Servansingh*, [1971] 3 All E.R. 113 (C.A.), concerned the liability of the original tenant to an assignee of the landlord with whom he shared neither privity of contract nor estate; *Cesteel Ltd.* v. *Alton House Holdings Ltd. (No. 2)*, [1987] W.L.R. 291 (C.A.), concerned the ability of a tenant's assignee to recover from the original landlord for a breach when there was neither privity of contract nor privity of estate between them.

unfairness which require correction. In the balance of this Chapter, we will discuss the problems of the present law and various options for reform and will recommend changes to the present law. In the hope of achieving clarity in a complex area, but at the risk of some repetition, we will also set out the principles which result from our proposals and their implications.

A. CONTINUING LIABILITY

1. Problems in the Law

The rules in *The Landlord and Tenant Act* and the common law which govern whether a covenant runs have been criticized as being arbitrary, illogical and often irrelevant to modern landlord and tenant practice[2] and as favouring the rights of landlords and their assignees over the rights of tenants and their assignees. They are certainly complex.

A rule which has received much of this criticism is the continuing liability rule: a landlord and tenant who enter into a lease remain obligated by the lease covenants until the term of the lease ends, even when one or both assigns his or her lease interest. Although the continuing liability principle applies equally to both landlords and tenants, its application to tenants is more common. It has been suggested that the main reason for this is that tenants usually undertake many more obligations than do landlords.[3] In addition though, this may reflect the fact that, in the negotiation of commercial leases, landlords generally hold the superior bargaining position.[4] Although landlords and tenants can agree to vary or abandon the continuing liability principle, it is probable that, given their relative bargaining strengths, most commercial landlords do not release their tenants from liability after assignment of their interests[5] and that most landlords insist upon their own release from liability when they assign their lease interests.[6] Thus, in practice, the continuing liability principle generally affects only original tenants who assign their lease interests.

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[2]*Grant* v. *Edmondson*, [1931] 1 Ch. 1 at 28 (C.A.).

[3]The Law Commission (Eng.), *Landlord and Tenant Law: Privity of Contract and Estate* (Report #174, 1988) 3.

[4]According to The Law Commission (Eng.), *id.*, at 15:

> The response to the Working Paper indicated that landlords are often in a dominant position in this market, which either makes it impractical for tenants to negotiate on equal terms or even deters them from trying. As one tenant put it to us, "there really is no alternative". The National Chamber of Trade explained the position by classing landlords as amongst "those with the greatest financial muscle". Solicitors from various parts of the country, who are regularly concerned with negotiating leases, confirmed our impression of the relative strengths of the parties in relation to continuing liability. The City of Westminster Law Society wrote that "the landlords' position has been so strong that it has been impossible to make bargains to the contrary". The Dorset Law Society spoke of the "greater bargaining power of landlords". This was echoed by the Barnsley Law Society, who pointed out, "Attempts to limit or exclude the doctrine [of continuing liability] . . . prove futile. Landlords are in too strong a bargaining position". In the words of the Nottinghamshire Law Society: "The general inequality of bargaining power between lessor and lessee . . . [makes] . . . efforts to negotiate changes to the [continuing liability] principle . . . futile".

H.M. Haber, *The Commercial Lease* (1989) vii - viii, also states:

> Most commercial tenants are not in a position to negotiate fair terms and conditions in the lease contract. Therefore, it is common to see fifty pages, more or less, in fine print, of a typical commercial lease drafted in favour of the landlord. The landlord grants the tenant space, a tenant mix and hopefully sufficient pedestrian traffic; but everywhere the tenant is bound. How many commercial tenants understand these leases let alone how many are in a position to negotiate the terms? How many can afford the fees of a solicitor to review these leases? How many solicitors will be able to change the terms? As the commercial lease is usually drafted by the landlord, one can expect that the terms and conditions will strongly favour the landlord. Except for anchor tenants and larger chain stores and lending institutions, the typical commercial tenant is generally helpless in his negotiations with the landlord. The law of supply and demand prevails in the market-place.

[5]See, *e.g.*, Haber, *id.*, at 303-305 and 141.

[6]See, *e.g.*, Haber, *id.*, at 310 and 151.

Some people feel that this is intrinsically unfair; they feel that a person should not continue to bear obligations under a lease in respect of which he or she no longer benefits nor has control.[7] They believe that the contractual obligations undertaken in a lease should regulate only the terms on which a current landlord permits a current tenant to occupy and use the property (or to sublet and profit from it). They argue that demands on an original tenant after assignment will often be unexpected, as most leases do not clearly indicate that the tenant remains liable throughout the term of the lease[8] and it is unlikely that the original tenant is informed of the continuing liability. As England's Law Commission stated:

> Most people who take a lease of property in England and Wales understand that this effectively gives them temporary ownership of the property during the period for which the lease is granted. They also understand that it involves them in obligations to pay the specified rent and comply with regulations which the lease prescribes, as to the purpose for which and manner in which the property is used, and other related matters. Probably the majority of leases permit the tenant to assign them to someone else, who then takes over the position of tenant. Leases are commonly assigned, frequently more than once. What comes as a considerable surprise, and sometimes a painful shock, to some people who have been tenants is that, even after they have parted with the property, they continue to have a responsibility to ensure that the obligations which they undertook in the lease are fulfilled.[9]

Although an original tenant who pays for a breach of covenant of his or her assignee has the right to be indemnified by the assignee, this right is of limited practical value, because the insolvency of the defaulting assignee is the usual reason for a landlord to seek recourse against the original tenant. The most significant problem for tenants is the payment of rent.[10] As mentioned earlier, a tenant's potential liability may be greater than what the tenant understood he or she had assumed and beyond his or her means. The original tenant is not entitled to notification when an assignee defaults and probably would not know about a default until he or she receives a claim, making it impossible to minimize his or her liability by taking prompt remedial action.[11] The principle is particularly unfair for long-term leases, as a tenant could be called upon to remedy the default of an assignee many years after he or she assigned the lease interest. Finally, an original tenant is not entitled to repossess the property when the assignee breaches a covenant.

At the same time, landlords, who are the beneficiaries of the continuing liability principle, may be unduly protected. Not only can they enforce the obligations in the lease against the original tenant, they can also enforce them against the current tenant and any intermediate assignees with whom they have contracted directly.[12] As England's Law Commission stated, "[t]his makes the principle one-sided, and unreasonably multiplies the remedies available to landlords."[13]

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[7]The Law Commission (Eng.), *Landlord and Tenant: Privity of Contract and Estate: Duration of Liability of Parties to Leases* (Working Paper #95, 1986) 22.

[8]The Law Commission (Eng.), *supra* n. 3, at 12.

[9]The Law Commission (Eng.), *supra* n. 7, at 1; similar sentiments are expressed in the Commission's final Report, *supra* n. 3, at 16.

[10]Law Reform Commission of British Columbia, *Commercial Tenancy Act* (Report #108, 1989) 49.

[11]The Law Commission (Eng.), *supra* n. 3, at 12.

[12]Sometimes landlords will enter into agreements respecting the covenant with such an assignee prior to a further assignment.

[13]The Law Commission (Eng.), *supra* n. 3, at 12.

Not every law reform agency which has considered this problem has thought it to be significant enough to warrant reform.[14] One agency considered that assignees who default in paying the rent usually do so soon after they become assignees and, therefore, claims against original tenants seldom occur many years after their assignments;[15] a second law reform agency expressed the view that, while the continuing liability of the assignor of a tenancy interest used to be problematic for residential leases, the principle has not generated similar problems for commercial tenancies.[16]

On the other hand, England's Law Commission considered that the number of cases involving the continuing liability of original tenants to leases is significant:

> The examples cited to us give no basis for making any statistical assessment of the number of actions to enforce the continuing liability of the original parties. But it is clear, and not surprising, that there are a large number of cases which are not publicly reported.
>
> Almost all examples cited to us concerned commercial property. . . . In relation to commercial properties there have been a number of reported cases in recent years. . . . It is clear from what we were told that these are only the tip of the iceberg. We have been given details of nearly 50 instances, mostly recent, and a number of correspondents said that they had been involved in others. These examples occur all over the country, and involve all types of business property: shops, offices, industrial premises and warehouses. The City of London Law Society reported the experience of one member firm, where relevant cases "probably equated to something in the order of less than half of 1% of all leases dealt with". That is a small percentage, but if it were the general experience it must still amount to a significant number, bearing in mind that there is a very large number of leases, and that the privity of contract principle is generally only involved in enforcement cases where action against the current tenant is unsuccessful or impractical.[17]

We too are convinced of the need for reform. We are troubled by the fact that the continuing liability principle has a much greater impact on tenants. We are particularly concerned that the present common law rule allows original tenants to be liable for much more than they originally bargained.

2. Abolition or Limitation of Continuing Liability

Given the greater impact on tenants and our desire to change the law only to the extent that is necessary, we will only consider reform of the tenant's continuing liability. That continuing liability could be abolished or, alternatively, could be limited in some fashion.

Abolition of the continuing liability of original tenants would result in ending their liability of original tenants for breaches subsequent to the assignment of their lease interest. Since original landlords often do not, in practice, have continuing obligations after they assign their lease interests, abolition of the continuing liability of tenants would result in the continuing obligations of original landlords and tenants being more equivalent. Abolition would also result

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[14]Law Reform Commission of British Columbia, *supra* n. 10, at 49-50; Ontario Law Reform Commission, *Landlord and Tenant Law* (Report, 1976) 35; Property Law and Equity Reform Committee (N.Z.), *Legislation Relating to Landlord and Tenant* (Report, 1986) 49 and 50.

[15]Property Law and Equity Reform Committee (N.Z.), *supra* n. 14, at 50.

[16]Law Reform Commission of British Columbia, *supra* n. 10, at 49-50. The Law Reform Commission concluded that the common law did not require amending. The respondents to the Commission's earlier Discussion Paper did not disagree with this view: Law Reform Commission of British Columbia, *Commercial Tenancy Act* (Discussion Paper #61, 1988).

[17]The Law Commission (Eng), *supra* n. 3, at 13. The Commission also noted (at 1) that a clear majority of those who responded to its Working Paper agreed that the present position was unsatisfactory and favoured a change in the law. Also see the Commission's conclusion at 18.

in greater similarity of Manitoba's commercial and residential tenancy law: residential tenants in Manitoba are not liable for breaches which occur after they assign their lease interests.[18]

However, abolition of the continuing liability of tenants could make assigning more difficult for tenants. At present, tenants are able to assign their lease interests with relative ease: where a lease requires the tenant to obtain the consent of the landlord to an assignment, a landlord can refuse it only on reasonable grounds.

Traditionally, landlords have been able to refuse to provide their consent to assignments in order to protect the lease premises from being used in an undesirable way or by an undesirable tenant or assignee.[19] However, in determining whether a landlord's refusal is reasonable, the courts now consider the surrounding circumstances, the commercial realities of the market place and the economic impact of an assignment on the landlord.[20]

For instance, in one case, the bankruptcy of the original tenant which prevented him from being compelled to fulfil a lease obligation was considered to be relevant to the court's determination of whether the landlord's refusal to consent to a proposed assignment of the lease by the mortgagee of the bankrupt tenant was reasonable.[21] Thus, it is possible that, if original tenants are not liable for breaches committed by their assignees, landlords might have a valid reason to refuse their consent to proposed assignments. In addition, courts might support the objections of landlords to consent where landlords would lose the greater security of original tenants.

Thus, abolishing the continuing liability of tenants could be an impediment to commerce: in exchange for getting rid of continuing potential future liability, original tenants would not be able to rid themselves of their immediate liability.[22] In our view, tenants would not welcome this result and instead would prefer easy assignability, albeit coupled with possible future liability.[23]

Abolition of the continuing liability of tenants could also make the process of assignment more time-consuming and expensive since landlords would probably want to scrutinize the credentials of proposed assignees more closely than they do now. In addition, abolition may result in rent increases if landlords feel the need to compensate themselves for the loss of security of the original tenant's continuing liability.[24]

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[18]*The Residential Tenancies Act*, C.C.S.M. c. R119, s. 48(a) and (c). The Act also contains an equivalent provision for landlords: s. 52(1).

[19]*Premier Confectionery (London) Co. Ltd.* v. *London Commercial Sale Rooms Ltd.*, [1933] 1 Ch. 904.

[20]*Federal Business Development Bank* v. *Starr* (1986), O.R. (2d) 65 (H.C.). Manitoba's courts have reiterated this view. In *Canada Safeway Ltd.* v. *Triangle Acceptance Ltd.* (1980), 5 Man. R. (2d) 22 (Co.Ct.), the Court noted that, although generally a refusal of consent is reasonable if it depends upon the lack of respectability and responsibility of the proposed assignee or subtenant or the protection of a right or interest in the lease, a reasonable refusal may also be founded upon rights or interests not protected or contemplated in the lease (e.g., contravention of the landlord's policy that there should not be different tenants in the premises carrying on the same trade in competition). Also see, *Moore* v. *New Progress Construction Ltd.* (1980), 9 Man. R. (2d) 434 at 439 (Co. Ct.), in which the Court indicated that a landlord is entitled to be informed about the assignee's identity and finances (for example, by personal character and credit references) and it is reasonable for him or her to refuse to consent to the assignment until this information is provided.

[21]*Federal Business Development Bank* v. *Starr*, *supra* n. 20, at 73. The Court indicated that, although the bank as mortgagee of the lease does not have the direct contractual responsibility of the original tenant to repair the lease premises, the landlord should not be prevented from asserting its right to require the repair obligation to be performed. The Court concluded that the landlord was not unreasonable in requiring repairs to be made as a condition precedent to consent to an assignment.

[22]Property Law and Equity Reform Committee (N.Z.), *supra* n. 14, at 49.

[23]This view was also taken by the New Zealand Law Commission: Law Commission (N.Z.), *The Property Law Act 1952* (Preliminary Paper #16, 1991) 147-148.

[24]The Law Commission (Eng.), *supra* n. 3, at 18.

An alternative to abolition is the reduction of an original tenant's continuing liability from primary liability to secondary liability as a guarantor after an assignment.[25] In this case, after a tenant assigns his or her lease interest, the landlord would be entitled to ask the original tenant to fulfil a lease promise only after the assignee breaches a covenant.[26] The following example illustrates the situation which would exist if a tenant's liability were limited to that of a guarantor after an assignment.

> Example. T and L enter into a lease. T assigns the lease interest to T1. A year later, T1 fails to pay the rent.
>
> L-------T
> | (assignment)
> T1
>
> Prior to T1's default, L can only seek payment of the rent from T1; unlike the current situation, L cannot seek payment from T. However, after T1 defaults, L can look to T for the rent. In this case, T, as guarantor, would be liable to L for the rent.

A consequence of limiting the liability of an original tenant to that of a guarantor would be that his or her obligations would be limited to those which were contemplated in the original lease; the original tenant would not be liable for the assignee's breach of a new obligation which was agreed upon by the landlord and the tenant's assignee without the original tenant's consent and which materially varied the lease.[27] For example, an original tenant would be liable for rent increases contemplated in a review clause in the lease but would not be liable for rent increases which were attributable to improvements agreed upon by the landlord and the tenant's assignee without his or her consent. In our opinion, limiting the liability of original tenants to matters which they themselves contemplated in the lease would result in greater fairness to original tenants as they do not benefit and may not even know about changes made to the lease interest subsequent to the assignment.

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[25]The New Zealand Law Commission provisionally recommended, in its preliminary paper, that, after an assignment, an original tenant should continue to be liable to the landlord for the performance of the assignee and subsequent assignees, as a guarantor: Law Commission (N.Z.), *supra* n. 23, at 148. However, after considering the responses to its preliminary paper, the Commission decided to confirm this proposal and to go even further. It recommended that an original tenant should be automatically released from future liability (as a guarantor) after a maximum of five years from the date of assignment of the lease. Although the Commission acknowledged the arbitrary nature of this solution, it felt that a cap of 5 years would be "sufficiently long to protect the legitimate interests of reasonable lessors": Law Commission (N.Z.), *A New Property Law Act*, *supra* n. 25, at 9-10.

[26]*Western Dominion Inv. Co. Ltd. v. MacMillan*, [1925] 2 D.L.R. 442 at 444 (Man. K.B.), aff'd [1925] 3 W.W.R. 456 (C.A.), where Dysart J. stated: ". . . a guaranty is a promise of one man to pay the debt of another if that other default. In every case of guaranty there are at least two obligations, a primary and a secondary. The secondary - the guaranty - is based upon the primary, and is enforceable only if the primary default." The creditor is not required to go to great lengths to compel the performance of the obligation by the person who is primarily liable before pursuing the person who guarantees the obligations. The creditor need not bring an action against the principal before making a claim against the guarantor, unless the guarantor will be prevented from recovering against the principal. Even where the creditor is subject to a statutory duty to sue the principal, the creditor may still be entitled to claim against the guarantor prior to commencing such an action. However, the guarantor may be able to insist that the creditor at least make a request of the primary debtor to fulfil the covenant: K.P. McGuinness, *The Law of Guarantee* (1986) 155-156.

[27]*Holland-Can. Mtge. Co. Ltd.* v. *Hutchings*, [1936] S.C.R. 165; *Rowlatt on the Law of Principal and Surety* (4th ed., 1982) 86. Alterations to the principal contract are generally presumed to be material unless they are clearly unsubstantial or necessarily beneficial to the guarantor: McGuinness, *supra* n. 26, at 251, citing *Holland-Can. Mtge. Co.* v. *Hutchings*. The author also states at 30: "Being of a secondary nature, a guarantee is completely dependent upon the unchanged continuance of the primary obligation, so that if any unauthorized change is made to the primary or principal obligation (such as by the creditor agreeing to extend time to the principal for payment, or by changing the nature of the primary contract by releasing a security that is fundamental to the primary obligation), the secondary guarantee obligation terminates." Also see, *Western Dominion Inv. Co. Ltd.* v. *MacMillan*, *supra* n. 26, at 444, per Dysart J.: "The secondary - the guaranty - is based upon the primary, and is enforceable only if the primary default. It is so completely dependent upon the *unchanged continuance* of that primary, that if any, even the slightest, unauthorized changes are made in the primary, as *e.g.*, by extension of time for payment, or by reducing the chances of enforcing payment, as, *e.g.*, by releasing any part of the securities, - the secondary thereby falls to the ground. In other words, the secondary is not only collateral to, but is exactly co-extensive with, the primary, as the primary existed when the secondary came into existence."

The original tenant's liability could be limited in other ways. For example, England's Law Commission proposed that, generally, the original tenant's continuing liability should end after his or her assignment.[28] Where it is reasonable for him or her to do so, the Commission proposed that a landlord should be able to require the original tenant to guarantee the performance of the lease covenants by his or her immediate assignee. Requiring a tenant to be a guarantor might be appropriate, for example, where the financial strength of a proposed assignee is doubtful. The original tenant's liability as a guarantor would end when the assignee made a subsequent assignment.[29] The Law Commission felt that a landlord would be protected throughout the term of the lease, as he or she could refuse to consent to a subsequent assignment where the loss of the original tenant's guarantee would leave him or her without sufficient security.[30] The following example demonstrates the original tenant's liability under this scheme.

> Example. T and L enter into a lease. T promises to insure the property. T assigns her interest to T1 and L requires T to guarantee T1's performance of the lease obligations. T1 fails to insure the property. Later, T1 assigns her interest to T2.
>
> L-------T
> |
> T1
> |
> T2
>
> When T assigns her interest to T1, T1 becomes primarily responsible for insuring the property and T guarantees T1's performance of the obligation to insure. When T1 defaults on the obligation to insure, L can ask T to fulfil this obligation. After T1's assignment to T2, T's liability for future breaches ends.

The Law Commission considered that the effect of their proposals would be that the liability of most original tenants for future breaches of lease obligations would end on an assignment of their interests.[31]

Having considered these options, on balance, we prefer to limit the continuing liability of an original tenant to that of a guarantor of the performance of the lease covenants by his or her assignee until the end of the term of the lease rather than to abolish the liability of the original tenant altogether. This reform recognizes that the party who is actually benefitting from the lease premises should be the party who is first called upon to satisfy the obligations under the lease. At the same time, it recognizes that the original tenant accepted a liability for a specific period of time - the entire term of the lease - and so cannot complain if he or she is called upon to make good a default of a subsequent tenant during that time. In keeping with the principle that the original tenant accepted certain obligations at the outset, it is reasonable that the original

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[28]The Law Commission (Eng.), *supra* n. 3, at 20.

[29]The Law Commission (Eng.), *supra* n. 3, at 21.

[30]The Law Commission (Eng.), *supra* n. 3, at 22. The Commission's recommendations were much more complex than this. It recommended that an exception should exist where a tenant assigns part of the lease interest, rather than the whole interest; the tenant should remain fully liable with the assignee for the covenants which affect the whole property. In addition, the Commission proposed changes to the liability of original landlords after their assignments. It proposed that a landlord should remain fully liable after an assignment until he or she notifies the tenant of his or her intention to assign and the tenant consents or does not object to the assignment. The Commission further proposed that, on a subsequent assignment by the assignee of the landlord, the original landlord, who either did not previously seek a release from liability or was refused, should be able to notify the current tenant of his or her wish to be released from liability. The landlord could be released even if the tenant objected to the proposed assignment, if the landlord can persuade a court of the reasonableness of his or her release from liability. Landlords with continuing liability would be jointly and severally liable (at 22-26).

[31]The Law Commission (Eng.), *supra* n. 3, at 20.

tenant no longer be liable for obligations which were not contemplated in the lease and which are agreed upon by his or her landlord and an assignee without his or her consent.

In addition, although we acknowledge that this option may slightly reduce the security of landlords after an assignment, we believe that it, more so than the English Commission's proposals, will provide landlords with the protection they need so that the present ease with which they consent to assignments will not change.

RECOMMENDATION 2

A tenant who enters into a lease and who later assigns a lease interest should be liable until the end of the term as a guarantor for a breach of the tenant's covenants which relates to the assigned interest and which is committed after the assignment.

3. Extension of Term

When a lease contains an option to extend the term and the tenant or tenant's assignee exercises the option, the term continues until the end of the extended period. In this section, we will consider whether the original tenant to a lease who has made an assignment should be liable as a guarantor for breaches during such an extension of the term.

At present, an original tenant's liability continues until the end of the extended term. The original tenant's liability is the same, whether the option to extend the term is exercised by him or her or by the tenant's assignee.

However, while we believe that it is fair for the original tenant to remain obligated until the end of an extended term when he or she has chosen to extend the lease, it seems to us unfair that the original tenant should remain obligated until the end of the extended term where he or she chose not to extend the term and, after assigning the lease interest, the assignee exercises the option to extend the term. Instead, we believe that fairness to the original tenant in these circumstances would be achieved only by ending the original tenant's liability at the end of the term provided in the original lease.

We do not feel that the same limitations have to be made for landlords. In our view, when a landlord agrees to include an option to extend the term in the lease, he or she realizes that, having done so, he or she relinquishes control over whether the option is exercised. For this reason, we feel that it is not unfair to the original landlord that he or she remains liable until the end of an extension of the term of the lease, whether the option to extend the term is exercised by the tenant or the tenant's assignee and whether the original landlord is the current landlord or the previous landlord when the option is exercised.[32]

RECOMMENDATION 3

When a tenant exercises an option to extend the term of the lease and later assigns the lease interest, the tenant should be liable as a guarantor for breaches of the tenant's lease covenants which occur after the assignment and before the end of the extended term. However, when an assignee of a tenant exercises an option to extend the term of the lease, the original tenant should be liable as a guarantor for breaches of the tenant's lease covenants which occur after the assignment only until the end of the term provided in the original lease.

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[32]As discussed previously, landlords usually are in a position to insist that their liability cease when they assign their lease interest.

RECOMMENDATION 4

There should be no change to the law that an original landlord is liable for breaches of the landlord's obligations which occur before the end of the term or extended term.

4. Law of Guarantee

The recommendation that the liability of an original tenant after an assignment of his or her lease interest should be limited to that of a guarantor has important implications. The common law of guarantee has developed rules which govern the rights and obligations of guarantors. These rules provide that a creditor cannot proceed against the guarantor until the primary debtor defaults, as is our intent. Of particular significance for landlords and tenants, they stipulate that a guarantor is not liable for a breach of an obligation which is agreed upon between the creditor (the landlord) and the principal debtor (the tenant's assignee) without the guarantor's (the original tenant's) consent, if that obligation differs in a material way from the obligations which were contemplated in the original lease.

The phrase "material variation" has been given meaning within the common law of guarantee. A material variation alters the business effect of the relationship so as to vary the risk[33] or is a variation ". . . that a prudent person might take into consideration in deciding whether to enter into a transaction."[34] Examples of what constitutes a material variation of a contract include the formation of a new agreement inconsistent with the original, an increase in the fixed rate of interest payable in respect to the guaranteed debt and delivery of an amount less than what was contemplated under the principal contract.[35]

The existence of this body of law makes it unnecessary to set out a detailed code in legislation of the particulars of the original tenant's continuing limited liability.

RECOMMENDATION 5

In general, the principles which have developed at common law in respect to the liability of guarantors should apply to an original tenant who becomes the guarantor of his or her assignee.

However, we believe that one exception should be made with respect to the application of the rules of guarantee. In the commercial tenancy context, if a tenant's assignee becomes bankrupt and the assignee's trustee in bankruptcy disclaims the lease, the original tenant (the guarantor) would be released from liability since the lease would cease to exist.[36] Clearly, this is not our intent. We have adopted the concept of guarantee in order to make the liability of the original tenant secondary to that of the assignee tenant. This particular consequence of the

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[33] *Pybus* v. *Gibb* (1856), 6 El.& Bl. 902, 119 E.R. 1100 (K.B.).

[34] McGuinness, *supra* n. 26, at 251.

[35] McGuinness, *supra* n. 26, at 253.

[36] *Warnford Investments Ltd.* v. *Duckworth*, [1979] 1 Ch. 127 at 138 (C.A.), per Megarry V.-C.:

> *Stacey* v. *Hill* [1901] 1 K.B. 660 seems to me to be a clear example of the liability of a surety perishing when there ceases to be any primary liability to make any further payments. Where there has been no assignment of a lease, and the lease is disclaimed on the bankruptcy of the original lessee, the lease is at an end, and so is any obligation of the lessee under it to pay any future rent. It follows that the liability of anyone who has guaranteed the payment of that rent is also at an end. With no lease in existence, and with the reversioner able to do as he wishes with the property, free from the lease, the surety cannot and ought not to be made liable for any more rent.

adoption of the law of guarantee must be displaced in order to give effect fully to our intent of subordinating, but not eliminating, the continuing liability of original tenants.

RECOMMENDATION 6

An exception should be made to the application of the rules of guarantee: the original tenant's liability as a guarantor of his or her assignee should not be affected by the assignee's bankruptcy and the disclaimer of the lease by the assignee's trustee in bankruptcy.

5. Resulting Principles

For greater clarity, we now restate the principles which would govern the law respecting the continuing liability of landlords and tenants as they would be following adoption of our proposed reforms.

Principle 1

An original landlord will be liable for a breach of a landlord's lease obligation which occurs during the term of the lease.

Principle 2

For the purpose of determining the liability of an original landlord, the term of a lease will include an extension of the term.

The landlord's liability continues throughout the term of the lease and is unaffected by any assignment. That liability continues during any extension of the term of the lease, irrespective of when the option to extend the lease is exercised or who exercises the option.

When a lease is renewed by an assignee landlord, as opposed to being extended, the original landlord's liability for further breaches of the landlord's lease covenants ends.

Principle 3

An original tenant will be primarily liable for a breach or portion of a breach of a tenant's lease obligation which occurs during the term of the lease and prior to him or her assigning the lease interest. An original tenant will be secondarily liable as a guarantor for a breach or portion of a breach of a tenant's lease obligation which occurs during the term of the lease after he or she assigns the lease interest.

Principle 4

For the purpose of determining an original tenant's liability, the term of a lease will include an extension of the term only where the original tenant exercises the option to extend the term.

The liability of an original tenant for tenant obligations will depend upon when a breach occurs. Prior to an assignment, a tenant will be obligated to perform each of the tenant's lease obligations; after an assignment, a tenant can be asked to perform the tenant's lease obligations only after the tenant's assignee defaults. If a breach begins prior to and continues after an assignment by the original tenant, the original tenant will be primarily liable for the portion of the breach which relates to the period prior to the assignment and secondarily liable as a guarantor for the portion of the breach which relates to the period after the assignment.

The liability of an original tenant during an extension of the term of the lease depends upon who exercises the option to extend the lease. An original tenant will be liable for a breach which occurs during an extension of the term if he or she exercises the option to extend the term. However, if the original tenant does not exercise the option, his or her liability will end at the end of the term agreed upon in the original lease; the subsequent exercise of the option by the tenant's assignee will not affect the original tenant's liability.

Principle 5

The liability of an original tenant for a breach which occurs after he or she assigns the lease interest will be governed by the law of guarantee. However, an original tenant will not be released from liability as a guarantor in the event that an assignee becomes bankrupt and his or her trustee in bankruptcy disclaims the lease.

Generally, the rules which have developed in the common law of guarantee will also apply to landlords and tenants where the original tenant has assigned the lease interest and is the guarantor of his or her assignee. Thus, if a tenant's assignee and the landlord (whether the original landlord or the landlord's assignee) vary the lease in a material way without the consent of the original tenant, the original tenant will not be liable for breaches which occur after the variation. The determination of what is a material variation of a lease will be governed by the same rules which govern the determination in other contracts of guarantee. Just as there are no requirements in the general law of guarantee that the creditor sue the principal-debtor before proceeding against the guarantor, so too there will be no need for a landlord to sue the tenant's assignee for a breach before commencing proceedings against the original tenant, as guarantor. However, in the event that the assignee of a tenant becomes bankrupt and his or her trustee in bankruptcy disclaims the lease, the original tenant will continue to be liable as a guarantor as if the lease still continued; thus, the landlord could continue to seek performance of the tenant's obligations from the original tenant.

B. DISTINCTIONS BETWEEN COVENANTS

The rules respecting whether a promise made by a landlord or tenant will benefit or obligate an assignee of the landlord or tenant are complex. It is probable that this complexity prevents many and probably most landlords and tenants from having a real understanding of the law which governs their relationship. What makes this worse is that a number of these rules are probably never contemplated by landlords and tenants and are impossible to rationalize. In the following sections, we will discuss the problems which are associated with these rules and how these problems might be resolved.

1. Touch and Concern

Most individuals probably are not aware that the enforceability of a covenant by or against an assignee of a landlord or tenant depends not only on the lease itself, but also on whether the covenant touches and concerns the land. Covenants must touch and concern the lease premises in order to benefit or obligate the assignees of the landlord or tenant;[37] those which do not cease to benefit or obligate them. Not only is there no apparent reason for these obligations of landlords and tenants to cease to be enforceable between the current landlord and tenant simply because of an assignment but, in addition, there is often little practical difference between a

[37]Ontario Law Reform Commission, *supra* n. 14, at 29-30.

covenant which concerns the lease premises and one which concerns other matters. The case law itself confirms the difficulty involved in differentiating between covenants that touch and concern the land and those which do not; the cases are very hard to reconcile. This difficulty results in parties to a lease being uncertain of their rights and obligations and results in litigation.

For these reasons, we concur with the view of the Ontario and New Zealand law reform commissions that differentiation of covenants on the basis of whether they touch and concern the lease premises is illogical.[38] Both the Ontario and New Zealand Commissions proposed the elimination of the requirement that covenants must touch and concern the land in order to run.[39] We adopt the comments of the Law Reform Commission of British Columbia which proposed that assignees of landlords and tenants should be obligated by and entitled to the same benefits as the original landlord or tenant:

> Three important points can be made in support of such a change. The first is that its simplicity would make the law more easily intelligible to landlords and tenants and to their legal advisors. Second, if two parties arrive at an agreement as to the terms of a commercial tenancy, it is reasonable to presume that they consider those terms fair, and that each party is prepared to fulfill his or her obligations. There is no obvious reason why some of those obligations should cease to be enforceable, simply because the tenancy or the reversion has been assigned to another party. Finally, such a reform measure is consistent with the broader evolution of the commercial tenancy from being a creature dominated by concepts of land-law, to one which incorporates a greater measure of modern contract law theory.[40]

England's Law Commission also recommended that the provisions in a lease should be considered to be a single bargain for the lease of the property and that an assignee of a landlord or tenant should take the assignor's place without distinctions being made between different categories of covenants. In their view, this would simplify the law and would result in the parties to a lease being certain of their obligations and entitlements.[41]

RECOMMENDATION 7

On an assignment, covenants should run, to benefit or obligate the assignees of landlords or tenants, whether or not they touch and concern the lease property.

2. Personal Service Covenants

A landlord and tenant may stipulate in their lease that one of them will provide certain services and they may intend that the provider of those services will continue to provide them even after he or she has assigned the lease interest. If the parties themselves are clear about their intention and if they clearly express it in their lease, then they will avoid the problem of who, as between the assignor and assignee, is responsible for providing the services after the party originally responsible assigns the lease interest.

However, where the parties do not clearly specify their intention, it may become necessary for a court to determine whether the obligation is personal to the original party and so does not become the obligation of the assignee or whether it is not a personal service covenant, and so runs with the assignment to obligate the assignee. Determining whether a covenant is or is not a

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[38]Ontario Law Reform Commission, *supra* n. 14, at 24; Law Commission (N.Z.), *The Property Law Act 1952*, *supra* n. 23, at 140.

[39]Ontario Law Reform Commission, *supra* n. 14, at 33-35; Law Commission (N.Z.), *A New Property Law Act*, *supra* n. 25, at 362-363 and 365-366.

[40]Law Reform Commission of British Columbia, *supra* n. 10, at 48.

[41]The Law Commission (Eng.), *supra* n. 3, at 19 and 27-28.

personal service covenant is not an easy matter, particularly because in many cases there is no obvious reason for preferring one person over another to perform the particular service.

One law reform agency has expressed the view that personal service obligations should be treated differently from other lease obligations and should not become the obligation of the assignee after an assignment.[42] The argument which was raised in favour of differential treatment was that it is likely that landlords and tenants expect that a personal service obligation in a lease would not run. However, in our view, it is more likely that landlords and tenants who do not specify otherwise expect that an obligation in a lease is integral to it and goes with the lease interest when it is assigned, whether or not it can be said that the particular obligation involves the performance of a personal service. In addition, we believe that commercial leases would only rarely contain a personal service covenant[43] and, therefore, an assignee would rarely become bound by an inappropriate personal service covenant.

Furthermore, a landlord and tenant can specify in their lease that a covenant is personal to its maker and, if the intention of the original parties is not clear, a prospective assignee can seek clarification from the assignor or the remaining party to the lease. In addition, since it is common for a party who remains in a lease and the prospective assignee of the other party to enter into an agreement concerning their obligations, the prospective assignee would have an opportunity to clarify and negotiate changes to his or her obligations.[44]

For these reasons, we concur with the Law Reform Commission of British Columbia:

> We are not convinced that such an exception is necessary or desirable. One of the aims of reform in this area is to eliminate distinctions that serve no clear or useful purpose. It is our impression that "true" personal service covenants have become something of a rarity and to preserve a highly technical distinction in the law to accommodate them achieves little.[45]

RECOMMENDATION 8

On an assignment, covenants should run to benefit or obligate the assignees of landlords or tenants, whether or not the covenant is a personal service covenant.

3. *In Posse/In Esse*

The distinction between covenants that pertain to matters which are in existence and matters which are not in existence when a lease is made is another example of a distinction which likely is not contemplated by most individuals who enter into a lease. The rule has been described as having no intelligible basis.[46] In addition, the rule developed only at common law in respect to assignments by tenants and was not incorporated into the legislation pertaining to assignments by landlords. Thus, the rule further complicates the law by applying only to tenants.

Cautious drafting of leases by lawyers has resulted in the benefits and obligations of covenants being transferable to the assignees of most commercial leases notwithstanding the rule

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[42]Ontario Law Reform Commission, *supra* n. 14, at 34.

[43]This was also the observation of the Property Law and Equity Reform Committee (N.Z.), *supra* n. 14, at 47.

[44]Property Law and Equity Reform Committee (N.Z.), *supra* n. 14, at 43-44.

[45]Law Reform Commission of British Columbia, *supra* n. 10, at 50.

[46]*Halsbury's Laws of England*, vol. 27(1) (4th ed., reissue) 437, n. 6. As noted in *Minshull* v. *Oakes* (1858), 2 H. & N. 793 at 808, 157 E.R. 327 at 333 (Ex. Div.), no reason is given in *Spencer's Case* (which first enunciated the rule) for distinguishing the running of covenants on the basis of whether the assignees are named or not in the lease.

that assignees of tenants are bound by covenants which pertain to matters in existence but not matters not yet in existence. However, even though the rule does not seem to be overly problematic in practice, there will always be some leases which fail to deal with this technical distinction correctly; this anachronism should be abolished. The rule has been abolished for residential tenancies in Manitoba[47] and, in England, it has been abolished for both commercial and residential leases.[48] The abolition of its application to commercial tenancies has been recommended by the British Columbia, Ontario and New Zealand Commissions.[49]

RECOMMENDATION 9

On an assignment, covenants should run, to benefit or obligate the assignees of landlords or tenants, whether or not the covenant pertains to a matter which is in existence or not yet in existence when the lease was made.

4. Resulting Principle

The principle which results from our recommendations and from the portion of the present law which we propose to retain can be stated as follows:

Principle 6

A covenant in a lease which benefits a landlord or tenant while he or she holds the lease interest will benefit his or her assignee while the assignee holds the lease interest. Similarly, a covenant in a lease which obligates a landlord or tenant while he or she holds a lease interest will obligate his or her assignee while he or she holds the assigned lease interest.

A covenant in a lease will benefit or obligate the assignee of a landlord or tenant while the assignee holds the lease interest, even if the covenant does not touch and concern the land, if it is a personal service covenant or if it pertains to something not yet in existence at the time of the lease. This will be so without the necessity of the lease stating that the covenant is entered into on behalf of assignees.

This will apply equally to a covenant, such as the covenant to pay rent, which is implied by the common law to be a part of every lease. Therefore, implied covenants will benefit or obligate the assignee of a landlord or tenant while the assignee holds the lease interest as though the covenant were expressed in the lease.

The rules respecting the running of covenants will apply both to assignments made with the consent of the parties and assignments which occur by operation of law (such as when a deceased tenant's personal representative becomes an assignee by virtue of entering into possession and enjoying the beneficial occupation of the premises). In addition, the obligations and benefits in the original lease will obligate and benefit the assignees of the landlord and tenant whether or not the lease is written or oral or a combination of these.

If a landlord and tenant wish that a particular covenant should not run, they would have to express this desire in their lease.[50]

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[47]*The Residential Tenancies Act*, C.C.S.M. c. R119, s. 192(3).

[48]*Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20, s. 79 (for leases entered into after 1925).

[49]Ontario Law Reform Commission, *supra* n. 14, at 63; Law Reform Commission of British Columbia, *supra* n. 10, at 134; Law Commission (N.Z.), *A New Property Law Act*, *supra* n. 25, at 365-366.

[50]The issue of waiver and contracting out is discussed more generally later in this Chapter.

C. LIABILITY FOR PROMISES OUTSIDE THE LEASE

As discussed in the previous Chapter, differences in the wording of sections 4 and 7 of *The Landlord and Tenant Act* suggest that, while a tenant's assignee is bound only by obligations contained in the lease, a landlord's assignee may be obligated by promises made by the original landlord outside the lease.[51] Although a lease may be written or oral, may consist of a series of correspondence and need not consist of a document that is labelled 'Lease', a promise may be made by a landlord to a tenant outside the lease.

The possibility that an assignee of a landlord could discover additional obligations promised by the original landlord in a document other than the lease after the assignment is made is obviously unsatisfactory.[52] After all, if the assignee had been made aware of those obligations prior to the assignment, he or she might have wished to negotiate a different price for the assignment or might even have not wanted to take on the assignment at all.

Although we believe that the possibility for problems in this area is remote, we would prefer to clarify the law and eliminate the potential. This could be accomplished by ensuring that new legislation provides clearly that an assignee of a landlord is obligated only by covenants contained in the lease.

The Ontario Law Reform Commission went further and recommended that most leases must be in written form;[53] however, we prefer not to do so. Although it is unlikely that parties to a commercial lease would enter into an oral lease, we would not restrict landlords and tenants from entering into one if they choose to do so. Indeed, we believe that restoring technical requirements of execution would be a retrograde step in a province which has repealed *The Statute of Frauds*; since its repeal in Manitoba, it is no longer necessary for a lease to be evidenced by deed.[54]

RECOMMENDATION 10

Only covenants that are contained in the lease should obligate the assignees of a landlord.

The following principle is the result of this recommendation and the present law which is retained:

Principle 7

An assignee of a landlord or tenant will be obligated or benefitted only by those covenants which obligate or benefit his or her assignor and which are contained in the lease.

Promises made by a landlord to a tenant or a tenant to a landlord which are not expressed in the lease (other than covenants which are implied by the common law to be a part of every lease) will neither benefit nor obligate the assignees of the landlord and tenant.

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[51]See discussion at pp. 21-22 of this Report.

[52]Ontario Law Reform Commission, *supra* n. 14, at 26-27.

[53]Ontario Law Reform Commission, *supra* n. 14, at 18. The Commission would permit exceptions for tenancy agreements for a term of one year or less.

[54]*An Act to repeal the Statute of Frauds*, S.M. 1982-83-84, c. 34, C.C.S.M. c. F158, s. 1.

D. LIABILITY OF ASSIGNORS VIS-A-VIS ASSIGNEES

At present, an original landlord or tenant is liable for breaches which occur throughout the term of the lease, even though he or she may have assigned his or her lease interest. At the same time, an assignee of the landlord or tenant is liable for breaches which begin prior to the assignment and continue after the assignment and for breaches which occur in their entirety after an assignment.

When a breach of a lease covenant is committed by an assignee, the original party to the lease who made the assignment may be called upon to pay damages or rent in respect to the breach. When an original landlord or tenant pays damages or rent in such a case, he or she is entitled to seek indemnification from the assignee, that is, the person who was the current landlord or tenant when the breach occurred.

However, when an assignee of a landlord or tenant pays damages or rent in respect of an entire breach which began prior to the assignment and continued after it, he or she is not entitled to indemnification from the assignor for the portion of the damages or rent which is attributable to the period prior to the assignment. The assignee is ultimately liable for a continuing breach and that liability includes the period of time prior to his or her taking the assignment.

We believe that this apportionment of ultimate liability does not accord with the probable and reasonable expectations of parties to a lease; instead, we think that most individuals would expect that each party should be ultimately responsible for the part of a breach which occurs while he or she holds the lease interest.

Such a change in the law would mean that two parties - the assignor and the assignee - would have to be sued for a continuing breach, rather than just one. Similarly, it would be necessary for courts to apportion liability between assignors and assignees. However, we believe that this would be more than outweighed by the greater simplicity in the rationale of the law and greater fairness to the parties which would be achieved by having the losses remain with those who were responsible for them.

RECOMMENDATION 11

A party to a lease, whether an original landlord or tenant or assignee of a landlord or tenant, should be ultimately liable for any breach or portion of a breach of covenant which is committed while he or she holds the lease interest to which the breach relates, notwithstanding any assignment of the lease interest.

Some covenants relate to the lease property as a whole and cannot be attributed to a particular part. Examples of such covenants are the covenant to pay rent[55] and covenants which have little direct connection to any part of the lease property, such as a landlord's obligation to give the tenant access to facilities separate from the lease property.[56] Special rules must be formulated regarding who will be liable for a breach of such covenants, in the event that the lease interest is divided by a partial assignment or by the assignment of the lease interest to two or more individuals who hold the interest separately.

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[55]Although in some cases, specific amounts of rent can be attributed to specific parts of the lease interest.

[56]The Law Commission (Eng.), *supra* n. 3, at 24-25.

RECOMMENDATION 12

If liability for a breach cannot be apportioned between parties who hold part of a lease interest separately because of the nature of the covenant, the holders of the part interests should be jointly and severally liable for the breach.

The principles which result from these recommendations and the related principles of the present law which are retained are as follows:

Principle 8

An original landlord or tenant or assignee of a landlord or tenant will be ultimately liable for a breach or portion of a breach of a landlord's or tenant's covenant, respectively, which occurs while he or she holds the lease interest to which the breach relates.

If an original landlord or tenant is required to pay damages or rent to the other party to the lease in respect to a breach which occurs while their assignee holds the lease interest, the party who makes the payment will be entitled to be indemnified for the payment by the person who held the lease interest to which the obligation relates at the time of the breach.

An original landlord or tenant will be entitled to partial indemnification for a breach of an obligation which commences while he or she is the current landlord or tenant and is continued by his or her assignee, for that portion of the damages or rent paid to the other party to the lease which is attributable to the time period when he or she did not hold the lease interest.

The following example demonstrates the consequences of the suggested reform.

Example. L promises in the lease to keep the lease premises in good repair. Afterward, L does not repair the fence. L assigns to L1. L1 does not repair the fence.

L-------T
|
L1

L will be responsible for the loss which is attributable to his failure to fix the fence while he was the landlord. L1 will be responsible for any loss which can be attributed to his failure to fix the fence while he was the landlord. T can choose to sue both L and L1 for the breach or L alone. If L alone is sued by T for the entire breach, after paying damages to T, L would be entitled to seek indemnification from L1 for the damages paid to T in respect to the portion of the breach which occurred after the assignment to L1.

Another consequence of this principle is that an assignee of a landlord or tenant will not be liable at all for a breach or portion of a breach which occurs while he or she does not hold the lease interest to which the breach relates. This means that an assignee will not be liable for a breach or portion of a breach which occurs prior to the assignment to himself or herself. In addition, an assignee who makes a subsequent assignment of his or her lease interest will not be liable for a breach or portion of a breach which occurs after the subsequent assignment in respect to the assigned interest.

Furthermore, when a landlord or tenant assigns only a part of his or her lease interest and retains part of the lease interest, the assignor landlord or tenant and the assignee will be

ultimately liable for breaches of the lease covenants which relate to their respective interests and which occur while they hold their respective interests. Similarly, when a landlord or tenant assigns part of his or her lease interest to one person and the balance of the lease interest to another person, the partial interest holders will be liable only for breaches which relate to their respective interest and which occur while they hold it.

Principle 9

The liability of an original landlord or tenant or an assignee of a landlord or tenant for a breach or portion of a breach of covenant which occurs while he or she holds the lease interest will not be affected by a subsequent assignment.

A landlord or tenant or assignee may be sued for a breach of covenant either while he or she holds the lease interest to which the breach relates or after he or she assigns the lease interest. The fact that a person no longer holds a lease interest does not prevent him or her from being sued for that part of a breach attributable to the period when he or she was landlord or tenant.

Principle 10

When a tenant's lease interest is divided because the tenant assigns only a portion of his or her lease interest or assigns all or part of his or her lease interest to more than one person who hold their interests separately, the entitlement of the landlord or landlord's assignee to exercise a right of re-entry or forfeiture for a breach of a covenant or condition pertains only to the portion of the lease interest to which the breach relates.

Principle 11

When, after an assignment, a breach of covenant cannot be attributed to a particular part of the lease property, the holders of the lease interests will be jointly and severally liable for the breach.

Any two individuals who, after an assignment, hold their lease interests at the same time may be jointly and severally liable for a breach of covenant if that covenant does not pertain to a specific part of the lease property and cannot be apportioned. If the breach gave the landlord or landlord's assignee a right to re-enter or forfeiture, the landlord's right would encompass the entire lease property.

E. RIGHT OF ASSIGNOR AND ASSIGNEE TO ENFORCE A COVENANT

As discussed in the preceding Chapter, sections 4 and 5 of *The Landlord and Tenant Act* have been interpreted by Manitoba's County Court as entitling only the original landlord to sue the tenant for arrears of rent which became due prior to an assignment by the landlord.[57] This interpretation of these provisions is contrary to the interpretation given to very similar provisions in the English legislation in several cases decided by England's Court of Appeal.[58]

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[57]*Sabray Investments Ltd.* v. *Hill*, [1978] 6 W.W.R. 721 (Man. Co. Ct.). The Court relied on case law, notably, *Brown* v. *Gallagher & Co.* (1914), 19 D.L.R. 682 (Ont. S.C.), as well as others which, in turn, relied on a much older English case, *Flight* v. *Bentley* (1835), 7 Sim. 149, 58 E.R. 793, for the proposition that the benefit of rent which accrued due before an assignment cannot be recovered by the landlord's assignee (unless expressly assigned).

[58]The English Court of Appeal has taken the position that the enactment of provisions similar to sections 4 and 5 of *The Landlord and Tenant Act* (Manitoba) changed the law to allow the landlord's assignee to sue the tenant for rent which became due prior to the landlord's assignment: *In re King*, [1963] 1 Ch. 459 (C.A.); *London and County (A & D) Ltd.* v. *Wilfred Sportsman Ltd.*, [1971] Ch. 764 (C.A.); *Arlesford Trading Co. Ltd.* v. *Servansingh*, *supra* n. 1.

It is hard to reconcile the Manitoba decision with these other decisions. Its result is that, in Manitoba, if a lease provides that the landlord is entitled to re-enter the lease premises for the non-payment of rent and the tenant breaches the obligation to pay rent so that arrears are due, the original landlord, after his or her assignment, would be entitled to sue for arrears of rent; however, the landlord would not be entitled to re-enter. At the same time, while the landlord's assignee would have no entitlement to sue for the arrears of rent, section 5 suggests that he or she would be entitled to enforce an unexercised right of re-entry or forfeiture for the tenant's non-payment of rent. What is unclear is whether the landlord's assignee would lose the right to re-enter on payment of the arrears by the tenant to the original landlord. It is also not clear whether, after the assignment, the original landlord and his or her assignee could at the same time seek to enforce their respective entitlements to arrears and re-entry (a rather bizarre result, it must be admitted). These uncertainties deserve to be addressed.

In addition, the rules respecting who is entitled to sue for a breach by the other party to the lease are unnecessarily complex. For no apparent reason of policy, different rules apply to landlords and tenants. Furthermore, the rules for who, as between a tenant and his or her assignee, is entitled to sue for a breach prior to the assignment differ depending upon whether the assignment by the tenant is registered under *The Real Property Act*.[59] Eliminating these differences would restore fairness and would simplify the law.

We will discuss the options for the reform of these rules in the context of both breaches which occur in their entirety prior to an assignment by the innocent party and breaches which begin before and continue after an assignment by the innocent party.

1. Breach Prior to an Assignment by the Innocent Party

The following examples demonstrate breaches which occur prior to an assignment by the innocent party.

> Example 1. L promises in a lease to pay the property taxes. L does not pay the 1993 property taxes. In 1995, T assigns the lease interest to T1.

> Example 2. T does not pay the rent for the month of October 1994, but resumes payment in November. In December, L assigns the lease interest to L1.

As we have indicated, we propose that the same rules should apply to both landlords and tenants for all assignments, whether they are registered or not. Accordingly, the rules respecting who is entitled to sue for a breach of covenant which occurs prior to an assignment by the innocent party could be simplified and clarified in one of two ways. The rights of landlords and tenants could be made uniform by passing the entitlement to sue for a breach committed entirely prior to an assignment to the innocent party's assignee. In the alternative, assignors of both landlords and tenants could retain the right to enforce breaches which occur prior to their assignment.

The first option, the right to sue for breaches committed prior to assignment passing to the assignee, would mean that a tenant of an unregistered lease who assigns would lose the right to sue for such a breach and the assignee of a tenant would gain that right. There would be no change to the present rule that a tenant loses his or her right to sue for damages which accrued prior to the assignment when the assignment is registered under *The Real Property Act*.[60] It

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[59]*The Real Property Act*, C.C.S.M. c. R30, s. 101(3).

[60]*The Real Property Act*, C.C.S.M. c. R30, s. 101(3).

would also mean that a landlord who assigns would lose his or her present right to sue for damages or rent which accrued to him or her prior to the assignment, while his or her assignee would be entitled to sue for damages or rent which accrued to the assignor-landlord prior to the assignment. There would be no change to the present rule that any unexercised right to re-entry or forfeiture of a landlord passes on an assignment to the landlord's assignee. Thus, the assignee of a landlord or tenant would be the only person entitled to sue for a breach which occurred prior to the assignment.

As Lord Diplock said in regard to the English legislation which provides for this result in respect to landlords:

> The effect of the section . . . is to enact a simple, rational and just rule of law. . . . The assignor suffers no loss, for the sale price of the reversion will take account of the value of the rights of action or other remedies against the tenant for antecedent breaches of covenant which are transferred to the assignee; the assignee will be able to enforce these remedies against the tenant; the tenant will remain liable for the diminution in value of the reversion caused by his breaches of covenant whenever committed.[61]

The Ontario and British Columbia Law Reform Commissions recommended this reform to the law.[62]

On the other hand, if assignors were to retain the right to sue for breaches committed prior to the assignment, then tenants who assign, but who do not register the assignment, would retain the right to sue for a breach committed in its entirety by the landlord prior to the assignment, while their assignees would continue to have no entitlement to sue for such a breach. Tenants who register their assignment under *The Real Property Act* would gain the right to sue for a breach committed in its entirety by the landlord prior to the assignment, while their assignees would lose this entitlement.[63] The rights of landlords who assign their interests also would remain the same: they would continue to be entitled to sue the tenant for damages or rent which became due to him or her prior to the assignment. The law would differ, however, in respect to rights regarding forfeiture and re-entry for a tenant's breach of covenant or condition; a landlord would lose the right on the assignment of his or her interest (unless he or she had already begun to exercise it) and the right would not pass to the assignee as it currently does. Manitoba's residential tenancy legislation takes this approach;[64] thus, this option would result in uniformity on this issue between Manitoba's residential and commercial tenancy law.

Before making a decision on this issue, we will discuss the related issue of breaches which begin prior to and continue after an assignment by the innocent party (continuing breaches).

2. Breach Prior to and Continued After an Assignment by the Innocent Party

The following are examples of continuing breaches.

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[61] *In re King*, *supra* n. 58, at 497-498.

[62] Ontario Law Reform Commission, *supra* n. 14, at 34; Law Reform Commission of British Columbia, *supra* n. 10, at 134. In May, 1993, a Bill very similar to the draft legislation in the Commission's Report was introduced into the British Columbia Legislature; the Bill would have repealed and replaced the *Commercial Tenancy Act*, R.S.B.C. 1979, c. 54: Bill 10, *Commercial Tenancy Act*, 2nd Sess., 35th Leg. B.C. 1993. However, the Bill did not proceed beyond First Reading.

[63] *The Real Property Act*, C.C.S.M. c. R30, s. 101(3).

[64] *The Residential Tenancy Act*, C.C.S.M. c. R119, ss. 48 and 52(1).

Example 1. L promises to repair the exterior of the lease property. In the spring of 1993, the lease building needs a new roof; L does not repair it. T assigns his lease interest to T1 in the fall of 1993. L does not repair the roof when T1 is the tenant.

Example 2. T promises to paint the interior of the lease premises on an annual basis. T does not paint in 1992 or 1993. In 1994, L assigns her lease interest to L1. T does not paint in 1994.

Again, eliminating the differences which exist in the present law for landlords and tenants regarding this type of breach could be accomplished in one of two ways. The assignee could be given the entitlement to sue for the entire continuing breach. In the alternative, an assignor and assignee landlord or tenant could each be entitled to sue the other party to the lease for that portion of the continuing breach which relates to the time during which they held their lease interest; in other words, assignors would be entitled to sue for the part of the breach which occurred prior to the assignment, while assignees would be entitled to sue for the part of the breach subsequent to the assignment.

The first option, giving the assignee the right to sue for the entire continuing breach, would not result in a change in the rights of landlords and their assignees; a landlord would continue to have no entitlement to sue, while a landlord's assignee would continue to be entitled to sue for the entire continuing breach. However, the present rights of tenants and their assignees would change; a tenant-assignor would lose the right to sue for the portion of the continuing breach which occurs prior to the assignment and the rights of his or her assignee would be expanded beyond the right to sue only for the portion of the breach which occurs after the assignment. This option would make commercial tenancy law and residential tenancy law uniform in this respect.[65]

If assignors and assignees were each entitled to sue the other party to the lease for the portion of the continuing breach which occurs while they hold their lease interest, the present law would not be changed in respect to the rights of tenants and their assignees. However, a landlord who assigns would obtain the new right to sue for the portion of a continuing breach which relates to the period prior to the assignment. An assignee of a landlord would lose his or her present right to sue the tenant for the entire continuing breach including the portion which is attributable to the period prior to the assignment and would be entitled to sue only for the portion of the breach which relates to the period after the assignment.

3. Recommendations and Principles

Having considered these options for reform, both in regard to breaches prior to an assignment and breaches which occur before and after an assignment by the innocent party, we believe that simplicity and fairness would best be achieved by relating entitlement to sue for a breach or portion of a breach with the right to receive the benefits of a lease interest. In other words, we feel that the law should be changed so that landlords, tenants and assignees would be entitled to sue for breaches or portions of breaches which occur while they hold their respective lease interests. We also feel that an innocent party should not lose his or her entitlement to sue simply because of an assignment.

[65] *The Residential Tenancies Act*, C.C.S.M. c. R119, ss. 48(b) and 52(1)(c).

RECOMMENDATION 13

A landlord or tenant who, at the time of a breach, holds a lease interest to which the breach relates should have the right to enforce the breach, and this right, with the exception of the entitlement to enforce the right to re-enter and forfeiture (which cannot be exercised by the landlord after he or she assigns the lease interest), should not be affected by the assignment of the lease interest.

RECOMMENDATION 14

Subsection 101(3) of The Real Property Act should be amended so that it is subject to The Landlord and Tenant Act.

To summarize, the principles which result from this recommendation and the rules of the present law which are retained are as follows:

Principle 12

A party who holds the lease interest when the other party breaches a lease obligation will be entitled to sue the party or parties who committed the breach.

Principle 13

With the exception of the landlord's rights of re-entry or forfeiture, a party to a lease will not lose his or her entitlement to enforce a breach or portion of a breach which occurs while he or she held a lease interest simply because he or she assigns the interest.

Thus, a party who is entitled to enforce certain obligations can commence proceedings either before or after assigning his or her interest. The exception to this, of course, relates to the right of a landlord to exercise his or her the right of re-entry or forfeiture. After assigning his or her lease interest, the landlord cannot exercise the right to re-enter or exercise forfeiture in respect to his or her former lease interest.

Of course, a landlord or tenant can choose to assign the right to remedy a breach which occurred before the assignment. If a landlord does so, the remedies to which he or she was entitled prior to the assignment will go with the assignment; this would include the landlord's right, if any, to re-entry and forfeiture.

F. SUBTENANCY

It has been suggested that eliminating the distinction which exists between subtenancies and assignments by tenants would simplify the law. Although this is always desirable, there are several persuasive reasons for retaining this distinction.

The parties to a lease may sometimes prefer the lack of enforceability of the lease covenants which is possible through a subtenancy relationship and we believe that they should be free to structure their relationship in this way, if they so choose (the landlord after all is unharmed by a subtenancy arrangement; he or she can still look to the party with whom he or she entered into the lease, the original tenant). The continued existence of subtenancies facilitates financial institutions lending money on the security of a tenant's lease; they can take an interest in the lease as subtenant, rather than as assignee and so avoid all the unwanted obligations to the landlord that that would entail. Furthermore, where desirable, subtenants and landlords can

always agree between themselves to be bound by the lease cove
privity of contract exists between the subtenant and the landlord (
that the landlord and subtenant can enforce the terms of the lease
Finally, retaining the distinction between subtenancies and assignn
the uniformity between commercial and residential tenancy law or
covenants of a residential landlord and tenant are not enforcea
subtenant unless the subtenant and landlord (or landlord's ass
agreement.[68]

Both the Ontario Law Reform Commission and the Law Re
Columbia concluded that legislation respecting subtenancies was no
their conclusion.

RECOMMENDATION 15

***The recommendations concerning the running of covenants
a landlord or tenant should not apply to subtenancies.***

As a result of this recommendation, the present law res
continue.

G. CONTRACTING OUT

The provisions of *The Landlord and Tenant Act* which conce
of landlords and tenants on assignments exist as a fall-back or defa
the extent that the parties do not address a situation in their leas
landlords and tenants to negotiate the terms of their leases betwee
we wish to leave this right undisturbed. As a rule, landlords ar
establish their relationship as they see fit.

However, if parties have an unrestricted right to contract out
which relates to covenants, we believe that, where landlords a
position, they will always insist that tenants remain fully liable aft
until the end of the term of the lease or the end of any extension of
be that our recommendations for the reduction of liability of origi
their interests would have little or no effect. We believe that f
variation not be permitted.

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[66]See, *e.g.*, Haber, *supra* n. 4, at 140 and 352, who suggests, at 352, that a commercial le
ensure that any person who is a transferee of a tenant's lease interest, including a subtena
"The following terms and conditions apply in respect of any Transfer . . . : . . . (d) Ten
Transferee to execute promptly an agreement (prepared by Landlord at Tenant's expense)
be bound by all of the terms of this Lease . . . as if the Transferee had originally executed
shall not be released from its obligations under this Lease and shall be (and shall caus
Indemnitor, to be) a party to such agreement, and the liability of Tenant and Transferee fo
Tenant under this Lease . . . shall be joint and several. . . ."

[67]Law Reform Commission of British Columbia, *supra* n. 10, at 50-51.

[68]*The Residential Tenancies Act*, C.C.S.M. c. R119, ss. 49 and 50.

always agree between themselves to be bound by the lease covenants.[66] When this happens, privity of contract exists between the subtenant and the landlord (or the landlord's assignee) so that the landlord and subtenant can enforce the terms of the lease against each other directly.[67] Finally, retaining the distinction between subtenancies and assignments by tenants would retain the uniformity between commercial and residential tenancy law on this issue; in Manitoba, the covenants of a residential landlord and tenant are not enforceable between a landlord and subtenant unless the subtenant and landlord (or landlord's assignee) enter into their own agreement.[68]

Both the Ontario Law Reform Commission and the Law Reform Commission of British Columbia concluded that legislation respecting subtenancies was not necessary.[69] We agree with their conclusion.

RECOMMENDATION 15

The recommendations concerning the running of covenants on an assignment by a landlord or tenant should not apply to subtenancies.

As a result of this recommendation, the present law respecting subtenancies would continue.

G. CONTRACTING OUT

The provisions of *The Landlord and Tenant Act* which concern the rights and obligations of landlords and tenants on assignments exist as a fall-back or default scheme which operates to the extent that the parties do not address a situation in their lease. We endorse the right of landlords and tenants to negotiate the terms of their leases between themselves and, generally, we wish to leave this right undisturbed. As a rule, landlords and tenants should be free to establish their relationship as they see fit.

However, if parties have an unrestricted right to contract out of every provision in the law which relates to covenants, we believe that, where landlords are in a superior bargaining position, they will always insist that tenants remain fully liable after they assign their interests until the end of the term of the lease or the end of any extension of the lease. The result would be that our recommendations for the reduction of liability of original tenants after they assign their interests would have little or no effect. We believe that fairness requires that such a variation not be permitted.

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[66]See, *e.g.*, Haber, *supra* n. 4, at 140 and 352, who suggests, at 352, that a commercial lease include the following provision to ensure that any person who is a transferee of a tenant's lease interest, including a subtenant, is bound by the terms of the lease: "The following terms and conditions apply in respect of any Transfer . . . : . . . (d) Tenant at its expense, (A) shall cause the Transferee to execute promptly an agreement (prepared by Landlord at Tenant's expense) directly with Landlord (i) agreeing to be bound by all of the terms of this Lease . . . as if the Transferee had originally executed this Lease as Tenant . . . ; but Tenant shall not be released from its obligations under this Lease and shall be (and shall cause, in addition to the Transferee, any Indemnitor, to be) a party to such agreement, and the liability of Tenant and Transferee for the fulfillment of any obligations of Tenant under this Lease . . . shall be joint and several. . . ."

[67]Law Reform Commission of British Columbia, *supra* n. 10, at 50-51.

[68]*The Residential Tenancies Act*, C.C.S.M. c. R119, ss. 49 and 50.

[69]Ontario Law Reform Commission, *supra* n. 14, at 30; Law Reform Commission of British Columbia, *supra* n. 10, at 50-51.

RECOMMENDATION 16

A landlord and tenant may agree to vary or waive any provision of The Landlord and Tenant Act which deals with covenants, except that they may not increase the liability of the original tenant after he or she assigns the lease interest from secondary liability as a guarantor for the duration of the term in the original lease or an extended period, if the original tenant has exercised the option to extend the term.

Principle 14

A landlord and tenant will be able to contract out of any provision in The Landlord and Tenant Act which concerns the running of covenants, with the exception that a landlord and tenant will not be able to agree to increase the liability of the original tenant from that of a guarantor of his or her assignee after the tenant assigns the lease interest.

H. TRANSITION

As a result of the reduction of liability of the original tenant after an assignment, landlords will likely exercise greater care when considering whether to consent to an assignment by a tenant. In addition, since all covenants in a lease, including personal service covenants, will benefit or obligate the assignees of the parties, parties who wish a different result will have to expressly specify their wishes in their lease. Because of these changes, we believe that it would be unfair to have our recommendations apply to landlords and tenants who have already entered into leases.

This would suggest that the new rules should apply only to new leases; this would result in a gradual shift from the old rules to the new rules over an indefinite period of time, as old leases expire and new leases are entered into. The new rules would apply to leases entered into after the new rules came into force; the old rules would continue to apply to existing leases.

However, two sets of rules applying to different leases at the same time for an indefinite period may lead to some confusion; we believe there must come a point at which the new rules apply to all leases and the old rules are irrevocably left behind. On balance, we feel that a compromise solution which would take into account the likely duration of existing leases and would ensure the eventual phasing out of the old rules would be best. The majority of commercial leases have a term of five to ten years and only a very few will have a term exceeding 25 years; accordingly, we believe that this is an appropriate point at which to end the application of the existing rules of covenants in commercial tenancies and to begin the full application of the new rules.

RECOMMENDATION 17

Legislation implementing the recommendations for reform in this Report should apply to all commercial leases entered into after it comes into force and to all commercial leases, regardless of when they are entered into, twenty-five years after that date.

The consequence of this recommendation is that, where a lease is entered into prior to the legislation being proclaimed, the lease will be governed for up to 25 years by the present laws and after that time by the new legislation.

I. IMPLEMENTATION

In order to better illustrate our recommendations and the resulting principles and to assist in their implementation, we have prepared draft amendments to *The Landlord and Tenant Act* which incorporate them. The draft amendments are set out in Appendix A. The next Chapter also sets out our suggested amendments, with explanatory notes.

CHAPTER 4

THE LANDLORD AND TENANT AMENDMENT ACT (ANNOTATED)

In this Chapter, we attempt to show how our proposals would work in practice. We set out a draft of an Act to amend *The Landlord and Tenant Act* with annotations to explain the intent and effect of each provision. The provisions of the Act are restated without annotations in Appendix A.

THE LANDLORD AND TENANT AMENDMENT ACT

Commentary

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Manitoba, enacts as follows:

The introduction indicates the provisions of the present Landlord and Tenant Act which are repealed.

C.C.S.M. c. L70 amended
1 The Landlord and Tenant Act is amended by this Act.

2 The heading "COVENANTS RUNNING WITH REVERSION" *that precedes section 3 is repealed.*

3 The heading "APPORTIONMENT OF CONDITION OF RE-ENTRY" *that precedes section 8 is repealed.*

4 Sections 3 to 8 are repealed.

5 The following is added after the heading "LEASES AND TENANCIES" *that follows section 2:*

DIVISION I

EFFECT OF ASSIGNMENT

Interpretation
2.1 In this Division,

"assignee landlord" means, notwithstanding section 1, any landlord whose interest in a tenancy agreement derives by assignment from another landlord;

"assignee tenant" means, notwithstanding section 1, any tenant whose interest in a tenancy agreement derives by assignment from another tenant;

An assignee landlord and assignee tenant is a person who is entitled to enforce the rights of a landlord or tenant under a tenancy agreement and who derives his or her interest in a tenancy agreement by a disposition from another person. An assignee landlord or tenant may be the heir, personal representative, successor in title or trustee in bankruptcy of the landlord or tenant, but does not include the original landlord or tenant who enters into the tenancy agreement.

"assignment" includes any disposition to another person, whether consensual or by operation of law, but does not include

(a) the creation of a subtenancy agreement, or

(b) an assignment made as security for the performance of an obligation, if the assignee has not asserted rights associated with an estate in the premises to enforce the security;

An assignment is a transfer from one person to another of an interest in a tenancy agreement which may occur as a result of the wishes of the parties or as a result of the application of established rules of law. For example, an assignment may occur as a result of the transfer of a debtor's property to his or her trustee in bankruptcy or as a result of the transfer of a deceased's property to his or her personal representative. Upon the death of a landlord or tenant, his or her personal representative (executor or administrator) steps into the place of the deceased, taking on all of his or her rights and obligations under the tenancy agreement (except that, typically, the personal representative is responsible only to the value of the estate). For the purposes of the Act, no assignment has taken place; that is, the personal representative is in the same legal position as was the deceased. However, an assignment is deemed to occur if and when the personal representative chooses to enter into possession and to enjoy the beneficial occupation of the lease interest. Similar principles will apply to trustees in bankruptcy.

A disposition of a tenant's interest in a tenancy agreement to another person for a period of time that is shorter than the term of the tenancy agreement (that is, a subtenancy) is not included within the definition of assignment. Also not included within the definition of assignment is a disposition by a landlord or tenant to another person of an interest in a tenancy agreement as security for the performance

of an obligation, provided that the person who is assigned the interest is not entitled to assert rights associated with the interest in the tenancy agreement. This situation might arise, for example, where a tenant borrows money from a lender and, as security for the debt, grants a security interest in his or her entire business undertaking, including the lease interest. In such a case, the lender will not be entitled to assert the rights of a tenant so long as the borrower tenant repays the borrowed money as agreed; the lender will be entitled to exercise its security and assert the rights of a tenant (for example, a tenant's right to occupy the premises) only when the borrower tenant does not perform the obligations as agreed upon between the borrower and the lender. When the lender becomes entitled to assert the rights of the tenant, the lender will at that point be considered to be an assignee and the provisions of Division I will apply to the assignment in the same way that they apply to other assignments.

"continuing breach" means a breach of an obligation in a tenancy agreement where the breach commences prior to, and continues after, the date of any assignment of that tenancy agreement;

A continuing breach is a breach which gives rise to a claim by or against both an assignor and an assignee. It may be a breach of an obligation in the tenancy agreement which begins while the innocent landlord or tenant holds his or her interest in the tenancy agreement and continues after the innocent party assigns his or her interest; for example, a continuing breach is committed when a landlord under an obligation to do so does not repair the premises and, while the breach is ongoing, the innocent tenant assigns his or her interest in the tenancy agreement. It may also be a breach of an obligation in a tenancy agreement which is committed by both parties to an assignment, begun by the assignor landlord or tenant and continued by his or her assignee; for example, a continuing breach is committed when a tenant under an obligation to do so does not repair the premises and assigns his or her interest in the tenancy agreement to an assignee who continues to breach the same obligation of repair.

"obligation" includes an obligation imposed by a covenant or by a condition in a tenancy agreement;

A landlord and tenant may be obligated by a covenant or a condition in a tenancy agreement. Currently, the remedies which are available to the innocent party to a tenancy agreement for a breach of covenant differ in one respect from the remedies which are available for a breach of condition: the innocent party is entitled to end the lease for a breach of condition, but is only entitled to sue for damages or rent for a breach of covenant unless the tenancy agreement expressly provides that the party may also end the tenancy agreement for a breach of that covenant. However, covenants and conditions will be afforded the same treatment for the purpose of the application of the provisions of Division I and so are both covered by the word "obligation".

"original landlord" means, notwithstanding section 1, any landlord whose interest in a tenancy agreement does not derive by assignment from another landlord;

"original tenant" means, notwithstanding section 1, any tenant whose interest in a tenancy agreement does not derive by assignment from another tenant;

The original landlord and tenant are the persons who together enter into the tenancy agreement. Because of their unique contractual relationship (privity of contract), the Act sets out a number of rules which apply only to the original landlord and tenant.

"tenancy agreement" includes an amendment to the tenancy agreement.

No restrictions are placed on what constitutes a tenancy agreement. Thus, the common law will continue to govern on this issue: a tenancy agreement may consist of a single document or a series of documents; it may be written or oral. However, for greater certainty, the Act provides that, when the terms of a lease are agreed upon and later amended, the original agreement together with its amendments make up the tenancy agreement.

Contracting out allowed

2.2(1) Subject to subsection (2), a party may agree with another party to vary or waive any provision of this Division.

The provisions in Division I apply to commercial tenancies only to the extent that a landlord and tenant do not agree upon other terms in their lease; a commercial landlord and tenant are free to agree to different rights and obligations than are provided by Division I. The only exception

to this freedom is set out in subsection (2).

Exception
2.2(2) No person may vary or waive section 2.6 so as to impose any greater liability on the assignor than would otherwise be imposed by that section and any agreement that purports to do so is void.

A landlord and tenant cannot agree to increase the liability of an original tenant who assigns his or her interest in the tenancy agreement from that of a guarantor of the performance of the tenant's tenancy obligations by the assignee. That liability extends until the end of the term of the tenancy agreement or an extension of the term, where the original tenant exercises the option to extend.

This means, for example, that an agreement between a landlord and tenant that the tenant remains primarily liable for breaches which occur in respect to the assigned interest after he or she assigns the interest will have no effect. It also means that an agreement by the parties that the original tenant will be primarily liable or liable as a guarantor for breaches which occur during an extension of the term of the tenancy agreement will have no effect when an assignee of the tenant exercises the option to extend.

However, a landlord and tenant can agree to decrease or eliminate the original tenant's liability as a guarantor after the tenant's assignment. For example, an agreement between a landlord and tenant that the tenant's liability ends altogether when he or she assigns his or her interest in the tenancy agreement will be valid.

Extent of Continuing Liability of Assignor

Landlords

Original landlord
2.3(1) An original landlord who assigns any interest under a tenancy agreement is, notwithstanding that assignment, liable for any breach of a landlord's obligation that occurs during the term of the tenancy agreement.

A landlord who enters into a tenancy agreement is primarily liable for breaches of the landlord's obligations until the tenancy agreement ends, even when he or she assigns an interest in the tenancy agreement. In other words, the original landlord will be liable for any breaches of the landlord's obligations whether those

breaches are committed by himself or herself, by his or her assignee or by a subsequent assignee, until the end of the tenancy agreement.

Extent of term

2.3(2) In subsection (1), "term" includes the period of any option to extend the term of the tenancy agreement where that option is exercised by any party before or after the original landlord's assignment of interest in that tenancy agreement.

The liability of the original landlord will extend to the end of any extension of the term of the tenancy agreement, where an option to extend the term in the tenancy agreement is exercised. This is so whether the option to extend the term is exercised by the tenant, the tenant's assignee or a subsequent assignee of the tenant and whether the option to extend the term is exercised while the original landlord holds his or her interest in the tenancy agreement or after the assignment of his or her interest.

Indemnification

2.3(3) A landlord who is liable under subsection (1) for a breach committed in whole or in part by any assignee is entitled to be indemnified by that assignee for the portion of the breach committed in regard to that assigned interest between the date of the assignment to that assignee and the date of any subsequent assignment by that assignee.

When an original landlord pays damages to the tenant or assignee of the tenant for a breach of a landlord's obligation, and the breach occurs either in whole or in part after the landlord assigns an interest in the tenancy agreement, the original landlord will be entitled to be indemnified by his or her assignee and any subsequent assignee for the damages which relate to the assigned interest and are attributable to the period after the assignment while the assignee was the current landlord.

For example, if an original landlord pays damages to the tenant because the landlord's assignee did not repair the lease premises, the original landlord will be entitled to be reimbursed by the assignee landlord for those damages. If an original landlord pays damages in respect to a failure to repair which begins while his or her immediate assignee holds the assigned interest and continues after that assignee makes a subsequent assignment, then the original landlord would be entitled to indemnification from both assignees in amounts which correspond to the proportion of the breach which is attributable to each assignee.

Assignee landlord

2.4 An assignee landlord who assigns any interest under a tenancy agreement has no liability for any breach of a landlord's obligation that occurs in regard to that assigned interest after the date of assignment.

Unlike the original landlord, an assignee of a landlord will not be liable after he or she assigns an interest in the tenancy agreement for breaches of the landlord's obligations which occur after the assignment. Of course, an assignee of a landlord who assigns only a portion of his or her interest in the tenancy agreement and retains another portion will continue to be primarily liable for any breaches of landlord's obligations which relate to the interest which he or she retains.

Who may sue

2.5 An original landlord and the assignee landlord at the time of a breach are liable to any person who is a tenant at the time of that breach.

An original landlord or landlord's assignee is liable to whomever holds the interest in the tenancy agreement to which the breach relates at the time of the breach; this may be the original tenant, the tenant's assignee, an assignee of the tenant's assignee or several of these persons.

Tenants

Original tenant

2.6(1) An original tenant who assigns any interest under a tenancy agreement has, notwithstanding that assignment, liability only as a guarantor for any breach of a tenant's obligation that occurs during the term of the tenancy agreement after the date of assignment.

An original tenant's liability for his or her obligations in the tenancy agreement changes when the tenant makes an assignment. The original tenant will not be primarily liable for a breach of a tenant's obligation which occurs after the assignment; he or she will be secondarily liable. After an assignment, the original tenant will be a guarantor of the performance of the tenant's obligations by his or her assignees until the end of the term of the lease. The effect is that the landlord or landlord's assignee can seek performance of a tenant's lease obligation by the original tenant only after the tenant's assignee (or a subsequent assignee) breaches the obligation.

Where an original tenant assigns part of his or her interest in the tenancy agreement, the tenant remains fully liable for the obligations in the lease which relate to the interest which he or she retains, but is liable only as a guarantor for those obligations which pertain to the interest which he or she assigns. For example, if a tenant promises to keep the lease premises in good repair

and then assigns half of the lease premises, after the assignment, the tenant will be primarily liable for any breaches of the repair obligation in respect to the interest which he or she retains. However, the tenant's assignee will be primarily liable for any failure to repair the assigned interest; only if the assignee fails to keep the assigned interest in repair can the landlord sue the original tenant for the breach.

Scope of "term"

2.6(2) In subsection (1), "term" includes the period of any option to extend the term of the tenancy agreement, where that option is exercised by the original tenant.

The secondary liability of the original tenant for breaches which occur after his or her assignment continues for the balance of the term of the tenancy agreement, including any extension resulting from an option to extend the term in the tenancy agreement which the original tenant himself or herself exercised. However, if the option to extend the term of the tenancy agreement was not exercised by the original tenant but was exercised by his or her assignee, the original tenant will not be liable at all for a breach which occurs after the end of the term originally provided in the tenancy agreement.

Law of guarantee applies

2.6(3) Subject to subsection (4), the law of guarantee applies to liability under subsection (1) with such modifications as the circumstances require.

The principles of the law of guarantee which govern the rights and obligations of a guarantor of a contract that is not a lease will also govern the rights and obligations of a tenant who assigns a lease interest and thereby becomes a guarantor of his or her assignee for the performance of the tenant's promises. For example, the principle that a guarantor of a contract is released from liability by a material variation of the contract by the debtor and creditor will also apply in the landlord and tenant context: a material variation of the tenancy agreement by the landlord (or landlord's assignee) and the tenant's assignee without the original tenant's consent (for example, a change in the use of the lease property which results in an increase in property taxes) will release the original tenant from liability for further breaches that relate to the assigned interest.

However, the original tenant will not be released from liability when a change to the lease occurs which was contemplated in the original lease. For example, if a lease

provides that the current landlord and tenant will review the rent on a yearly basis, then, an increase in rent in accordance with this provision will not release the original tenant from further liability.

Exception
2.6(4) Notwithstanding any disclaimer of a tenancy agreement by a trustee in bankruptcy of any assignee tenant, the tenancy agreement is deemed to be in existence for the balance of its term for the purposes of the original tenant's liability.

According to the law of guarantee, the obligations of a guarantor depend entirely upon the obligations of the principal debtor. This can have one unintended consequence in the landlord and tenant context. Bankruptcy of an assignee of the original tenant entitles the assignee's trustee in bankruptcy to disclaim the lease; this has the effect of ending the lease and thus would end the liability of the original tenant as guarantor.

This subsection prevents this result. In the event that an assignee of the tenant becomes bankrupt and the assignee's trustee in bankruptcy disclaims the lease, the original tenant will remain liable until the end of the term of the lease, as though the lease had not been disclaimed (although the lease will still end for other purposes).

Assignee tenant
2.7 An assignee tenant who assigns any interest under a tenancy agreement has no liability for any breach of a tenant's obligation that occurs in regard to that assigned interest after the date of assignment.

Unlike the original tenant, an assignee of a tenant will not be liable for a breach which occurs after he or she makes a subsequent assignment. Of course, an assignee of a tenant who assigns only a portion of his or her interest in the tenancy agreement and retains another portion will continue to be fully liable for any breaches of the tenant's obligations which relate to the interest which he or she retains.

Who may bring suit
2.8 An original tenant and the assignee tenant at the time of a breach are liable to any person who is a landlord at the time of that breach.

An original tenant or tenant's assignee is liable to whomever holds the interest in the tenancy agreement to which the breach relates at the time of the breach; this may be the original landlord, the landlord's assignee, an assignee of the landlord's assignee or several of these persons.

Assignment of partial interests

2.9 Where a party assigns an interest under a tenancy agreement so that two or more persons separately hold partial interests and the obligation that is breached

(a) can be apportioned between the separated interests, the obligation is divisible between the separated interests and will accompany each interest, notwithstanding that it is a condition or confers a right of re-entry;

(b) cannot be apportioned between the separated interests, the persons who hold the partial interests are, notwithstanding anything in this Act, jointly and severally liable for the breach.

It is possible for an assignment of a tenancy agreement to result in more than one person holding an interest in the lease property. A landlord or tenant can assign part of his or her interest and retain the other part or can assign part to one person and the rest to another person. In either case, the persons who hold the part interests are obliged to perform the obligations which pertain to their respective interests and will be liable for any breaches of the obligations which relate to their respective interests, so long as the obligations can be divided between the separated interests. Where obligations relate to the entire property and are not capable of being divided, the person who is entitled to their benefit can sue either or both of the parties who hold a separate interest and they will be jointly and severally liable for the breach.

Continuing right of assignor to sue

2.10(1) Subject to subsection (2), where a party assigns any interest under a tenancy agreement, the assignor may sue the other party or any assignee of the other party for

(a) damages for breach of any of that party's obligations that commences or is committed prior to the date of assignment while the assignor was the landlord or tenant, as the case may be; or

(b) arrears of rent incurred prior to the date of assignment while the assignor was the landlord.

When a landlord or tenant breaches an obligation in the tenancy agreement and, after the breach ends or while the breach is continuing, the innocent party to the tenancy agreement assigns his or her interest, the innocent party who makes the assignment remains entitled to sue the wrongdoer for the damages or rent which relates to the breach which occurred while he or she held his or her interest. The assignment does not take away this right.

Limited damages for continuing breach

2.10(2) Where an assignor sues under subsection (1) for a continuing breach, the assignor may recover damages or arrears of rent, as the case may be, only for that part of the breach that is committed in regard to that interest prior to the date of assignment.

Assignee's Entitlement to Benefits and Assumption of Obligations

Benefits and obligations of assignee

2.11(1) A person who takes an assignment of any interest from a landlord or tenant is entitled to all the benefits and assumes all the obligations of the assignor with respect to that interest that

(a) are contained in the tenancy agreement; and

(b) wholly or partially arise subsequent to the date of assignment.

Where a landlord or tenant assigns an interest in a tenancy agreement, the assignee is bound to perform, and entitled to benefit from, the promises made by the parties which relate to the assigned interest, provided that those promises are contained in the lease. The assignee will not be bound by nor entitled to benefit from promises made between the original landlord and tenant outside the lease.

The assignee's obligation to perform and entitlement to benefit from the promises in the tenancy agreement last only for so long as he or she holds the assigned interest, that is, from the time of taking the assignment until the lease ends or until he or she makes a subsequent assignment. This means that, if a landlord or tenant breaches an obligation and the breach continues after the innocent party assigns his or her lease interest, the assignee of the innocent party will be entitled to sue the wrongdoer for the portion of the breach which occurs subsequent to the assignment, but not for the portion of the breach which occurs prior to the assignment. Similarly, if a landlord or tenant breaches an obligation and then assigns his or her interest in the tenancy agreement and the breach is continued by his or her assignee, the assignee will not be liable for the portion of the breach which occurs prior to the assignment.

All benefits and obligations run

2.11(2) Without limiting its generality, subsection (1) applies to a benefit or obligation notwithstanding that it

(a) does not touch, concern or have reference to the subject matter of the tenancy agreement;

(b) is a personal service obligation; or

(c) relates to something not in existence at the time the tenancy agreement was entered.

An assignee of a landlord or tenant is obligated by or benefitted by the promises made by the landlord or tenant in accordance with the rules set out in s. 2.11 (1) without distinctions being drawn between promises which touch and concern the lease premises and those which do not, between promises which relate to personal service and those which do not, and between promises which relate to something which exists and those which relate to something not yet in existence at the time that the tenancy agreement was made. All promises in a tenancy agreement will be treated in the same way, unless a landlord and tenant indicate their desire to afford different treatment to a particular promise.

Assignment of arrears

2.12 Where any original or assignee landlord assigns to an assignee landlord an interest in the tenancy agreement and entitlement to enforce any breach which occurs prior to the assignment, that assignee landlord is entitled to enforce any remedy that the assignor could have enforced in respect of the breach, including the rights of re-entry and forfeiture.

A landlord or tenant or assignee of a landlord or tenant may assign any right to enforce any breach which occurs prior to the assignment. When a landlord or a landlord's assignee does so, the assignee who obtains the entitlement to sue for a breach which occurred prior to the assignment will be entitled to any remedy which had been available to the assignor landlord. Thus, for example, the assignment by a landlord of the right to rent which was due and unpaid prior to the assignment would entitle the landlord's assignee to exercise the right to re-enter or forfeiture (if the landlord had this entitlement). Naturally, an assignor who assigns his or her rights to enforce a breach which occurred prior to the assignment thereby loses any entitlement with respect to that breach.

Assignee's right to sue for continuing breach

2.13 Where a party commits a continuing breach, an assignee of the other party may sue the wrongdoer for rent or damages or may enforce the right of re-entry or forfeiture, as the case may be, in respect of that part of the continuing breach that occurs after the date of assignment.

When a party breaches an obligation and the breach continues after the other (innocent) party assigns his or her interest in the tenancy agreement, the innocent assignee is entitled to sue only in respect to the portion of the breach which occurs after the assignment and not in respect to the portion of the breach which occurred prior to the assignment (of course, as noted in s. 2.12, the innocent assignor could assign his or her right to enforce the part of the breach occurring prior to the assignment). For example, if a tenant does not pay the rent for two months, the landlord assigns his or her interest and the tenant continues not to pay the rent for another three months, the landlord's assignee is entitled to sue the tenant only for the rent which is due after he or she is assigned the interest in the tenancy agreement (in the example, the last three months).

Transitional

Application of new Division

2.14(1) This Division applies to every tenancy agreement entered on or after the coming into effect of this Division.

For twenty-five years following its coming into effect, the new legislation will apply only to commercial tenancies which are entered into on or after its effective date; sections 3 to 8 of the present legislation will continue to apply to commercial tenancies

which are entered into prior to the date on which the new legislation comes into effect. However, 25 years following the day on which it comes into effect, the new legislation will apply to all commercial tenancies in Manitoba, including any which were entered into before the new legislation came into effect and which are still in force.

Continuation of former provisions
2.14(2) Sections 3 to 8 of The Landlord and Tenant Act as enacted immediately prior to the coming into force of this Division continue to apply to every tenancy agreement entered before the coming into effect of this Division.

Eventual application to all
2.14(3) Notwithstanding subsection (2), commencing twenty-five years after the date on which this Division comes into effect, this Division applies to all tenancy agreements regardless of when they are entered.

6 The heading "DIVISION II" *is added before the heading* "SUB-LESSEE AND TITLE TO REVERSION" *that precedes section 9.*

Coming into force
7 This Act comes into force on a day fixed by proclamation.

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CHAPTER 5

LIST OF RECOMMENDATIONS AND PRINCIPLES

A. RECOMMENDATIONS

The following is a list of the recommendations for changes to the law of covenants in commercial tenancies contained in this Report:

1. The provisions in *The Landlord and Tenant Act* which pertain to covenants should be rewritten in modern, clear and simple language. (p. 25)

2. A tenant who enters into a lease and who later assigns a lease interest should be liable until the end of the term as a guarantor for a breach of the tenant's covenants which relates to the assigned interest and which is committed after the assignment. (p. 32)

3. When a tenant exercises an option to extend the term of the lease and later assigns the lease interest, the tenant should be liable as a guarantor for breaches of the tenant's lease covenants which occur after the assignment and before the end of the extended term. However, when an assignee of a tenant exercises an option to extend the term of the lease, the original tenant should be liable as a guarantor for breaches of the tenant's lease covenants which occur after the assignment only until the end of the term provided in the original lease. (p. 32)

4. There should be no change to the law that an original landlord is liable for breaches of the landlord's obligations which occur before the end of the term or extended term. (p. 33)

5. In general, the principles which have developed at common law in respect to the liability of guarantors should apply to an original tenant who becomes the guarantor of his or her assignee. (p. 33)

6. An exception should be made to the application of the rules of guarantee: the original tenant's liability as a guarantor of his or her assignee should not be affected by the assignee's bankruptcy and the disclaimer of the lease by the assignee's trustee in bankruptcy. (p. 34)

7. On an assignment, covenants should run, to benefit or obligate the assignees of landlords or tenants, whether or not they touch and concern the lease property. (p. 36)

8. On an assignment, covenants should run to benefit or obligate the assignees of landlords or tenants, whether or not the covenant is a personal service covenant. (p. 37)

9. On an assignment, covenants should run, to benefit or obligate the assignees of landlords or tenants, whether or not the covenant pertains to a matter which is in existence or not yet in existence when the lease was made. (p. 38)

10. Only covenants that are contained in the lease should obligate the assignees of a landlord. (p. 39)

11. A party to a lease, whether an original landlord or tenant or assignee of a landlord or tenant, should be ultimately liable for any breach or portion of a breach of covenant which is committed while he or she holds the lease interest to which the breach relates, notwithstanding any assignment of the lease interest. (p. 40)

12. If liability for a breach cannot be apportioned between parties who hold part of a lease interest separately because of the nature of the covenant, the holders of the part interests should be jointly and severally liable for the breach. (p. 41)

13. A landlord or tenant who, at the time of a breach, holds a lease interest to which the breach relates should have the right to enforce the breach, and this right, with the exception of the entitlement to enforce the right to re-enter and forfeiture (which cannot be exercised by the landlord after he or she assigns the lease interest), should not be affected by the assignment of the lease interest. (p. 46)

14. Subsection 101(3) of *The Real Property Act* should be amended so that it is subject to *The Landlord and Tenant Act*. (p. 46)

15. The recommendations concerning the running of covenants on an assignment by a landlord or tenant should not apply to subtenancies. (p. 47)

16. A landlord and tenant may agree to vary or waive any provision of *The Landlord and Tenant Act* which deals with covenants, except that they may not increase the liability of the original tenant after he or she assigns the lease interest from secondary liability as a guarantor for the duration of the term in the original lease or an extended period, if the original tenant has exercised the option to extend the term. (p. 48)

17. Legislation implementing the recommendations for reform in this Report should apply to all commercial leases entered into after it comes into force and to all commercial leases, regardless of when they are entered into, twenty-five years after that date. (p. 48)

B. PRINCIPLES

If the Commission's recommendations for reform were implemented, the following principles would govern the law of covenants in commercial tenancies:

1. *An original landlord will be liable for a breach of a landlord's lease obligation which occurs during the term of the lease.* (p. 34)

2. *For the purpose of determining the liability of an original landlord, the term of a lease will include an extension of the term.* (p. 34)

3. *An original tenant will be primarily liable for a breach or portion of a breach of a tenant's lease obligation which occurs during the term of the lease and prior to him or her assigning the lease interest. An original tenant will be secondarily liable as a guarantor for a breach or portion of a breach of a tenant's lease obligation which occurs during the term of the lease after he or she assigns the lease interest.* (p. 34)

4. *For the purpose of determining an original tenant's liability, the term of a lease will include an extension of the term only where the original tenant exercises the option to extend the term.* (p. 34)

5. *The liability of an original tenant for a breach which occurs after he or she assigns the lease interest will be governed by the law of guarantee. However, an original tenant will not be released from liability as a guarantor in the event that an assignee becomes bankrupt and his or her trustee in bankruptcy disclaims the lease.* (p. 35)

6. *A covenant in a lease which benefits a landlord or tenant while he or she holds the lease interest will benefit his or her assignee while the assignee holds the lease interest. Similarly, a covenant in a lease which obligates a landlord or tenant while he or she holds a lease interest will obligate his or her assignee while he or she holds the assigned lease interest.* (p. 38)

7. *An assignee of a landlord or tenant will be obligated or benefitted only by those covenants which obligate or benefit his or her assignor and which are contained in the lease.* (p. 39)

8. *An original landlord or tenant or assignee of a landlord or tenant will be ultimately liable for a breach or portion of a breach of a landlord's or tenant's covenant, respectively, which occurs while he or she holds the lease interest to which the breach relates.* (p. 41)

9. *The liability of an original landlord or tenant or an assignee of a landlord or tenant for a breach or portion of a breach of covenant which occurs while he or she holds the lease interest will not be affected by a subsequent assignment.* (p. 42)

10. *When a tenant's lease interest is divided because the tenant assigns only a portion of his or her lease interest or assigns all or part of his or her lease interest to more than one person who hold their interests separately, the entitlement of the landlord or landlord's assignee to exercise a right of re-entry or forfeiture for a breach of a covenant or condition pertains only to the portion of the lease interest to which the breach relates.* (p. 42)

11. *When, after an assignment, a breach of covenant cannot be attributed to a particular part of the lease property, the holders of the lease interests will be jointly and severally liable for the breach.* (p. 42)

12. *A party who holds the lease interest when the other party breaches a lease obligation will be entitled to sue the party or parties who committed the breach.* (p. 46)

13. *With the exception of the landlord's rights of re-entry or forfeiture, a party to a lease will not lose his or her entitlement to enforce a breach or portion of a breach which occurs while he or she held a lease interest simply because he or she assigns the interest.* (p. 46)

14. *A landlord and tenant will be able to contract out of any provision in The Landlord and Tenant Act which concerns the running of covenants, with the exception that a landlord and tenant will not be able to agree to increase the liability of the original tenant from that of a guarantor of his or her assignee after the tenant assigns the lease interest.* (p. 48)

This is a Report pursuant to section 15 of *The Law Reform Commission Act*, C.C.S.M. c.

L95, signed this 28th day of March 1995.

Clifford H.C. Edwards, President

John C. Irvine, Commissioner

Gerald O. Jewers, Commissioner

Eleanor R. Dawson, Commissioner

Pearl K. McGonigal, Commissioner

APPENDIX A

THE LANDLORD AND TENANT AMENDMENT ACT (DRAFT LEGISLATION)

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Manitoba, enacts as follows:

C.C.S.M. c. L70 amended
1 The Landlord and Tenant Act is amended by this Act.

2 The heading "COVENANTS RUNNING WITH REVERSION" *that precedes section 3 is repealed.*

3 The heading "APPORTIONMENT OF CONDITION OF RE-ENTRY" *that precedes section 8 is repealed.*

4 Sections 3 to 8 are repealed.

5 The following is added after the heading "LEASES AND TENANCIES" *that follows section 2:*

DIVISION I

EFFECT OF ASSIGNMENT

Interpretation
2.1 In this Division,

"assignee landlord" means, notwithstanding section 1, any landlord whose interest in a tenancy agreement derives by assignment from another landlord;

"assignee tenant" means, notwithstanding section 1, any tenant whose interest in a tenancy agreement derives by assignment from another tenant;

"assignment" includes any disposition to another person, whether consensual or by operation of law, but does not include

(a) the creation of a subtenancy agreement, or

(b) an assignment made as security for the performance of an obligation, if the assignee has not asserted rights associated with an estate in the premises to enforce the security;

"continuing breach" means a breach of an obligation in a tenancy agreement where the breach commences prior to, and continues after, the date of any assignment of that tenancy agreement;

"obligation" includes an obligation imposed by a covenant or by a condition in a tenancy agreement;

"original landlord" means, notwithstanding section 1, any landlord whose interest in a tenancy agreement does not derive by assignment from another landlord;

"original tenant" means, notwithstanding section 1, any tenant whose interest in a tenancy agreement does not derive by assignment from another tenant;

"tenancy agreement" includes an amendment to the tenancy agreement.

Contracting out allowed
2.2(1) Subject to subsection (2), a party may agree with another party to vary or waive any provision of this Division.

Exception
2.2(2) No person may vary or waive section 2.6 so as to impose any greater liability on the assignor than would otherwise be imposed by that section and any agreement that purports to do so is void.

Extent of Continuing
Liability of Assignor

Landlords

Original landlord
2.3(1) An original landlord who assigns any interest under a tenancy agreement is, notwithstanding that assignment, liable for any breach of a landlord's obligation that occurs during the term of the tenancy agreement.

Extent of term
2.3(2) In subsection (1), "term" includes the period of any option to extend the term of the tenancy agreement where that option is exercised by any party before or after the original landlord's assignment of interest in that tenancy agreement.

Indemnification
2.3(3) A landlord who is liable under subsection (1) for a breach committed in whole or in part by any assignee is entitled to be indemnified by that assignee for the portion of the breach committed in regard to that assigned interest between the date of the assignment to that assignee and the date of any subsequent assignment by that assignee.

Assignee landlord
2.4 An assignee landlord who assigns any interest under a tenancy agreement has no liability for any breach of a landlord's obligation that occurs in regard to that assigned interest after the date of assignment.

Who may sue
2.5 An original landlord and the assignee landlord at the time of a breach are liable to any person who is a tenant at the time of that breach.

Tenants

Original tenant
2.6(1) An original tenant who assigns any interest under a tenancy agreement has, notwithstanding that assignment, liability only as a guarantor for any breach of a tenant's obligation that occurs during the term of the tenancy agreement after the date of assignment.

Scope of "term"
2.6(2) In subsection (1), "term" includes the period of any option to extend the term of the tenancy agreement, where that option is exercised by the original tenant.

Law of guarantee applies
2.6(3) Subject to subsection (4), the law of guarantee applies to liability under subsection (1) with such modifications as the circumstances require.

Exception
2.6(4) Notwithstanding any disclaimer of a tenancy agreement by a trustee in bankruptcy of any assignee tenant, the tenancy agreement is deemed to be in existence for the balance of its term for the purposes of the original tenant's liability.

Assignee tenant
2.7 An assignee tenant who assigns any interest under a tenancy agreement has no liability for any breach of a tenant's obligation that occurs in regard to that assigned interest after the date of assignment.

Who may bring suit
2.8 An original tenant and the assignee tenant at the time of a breach are liable to any person who is a landlord at the time of that breach.

General

Assignment of partial interests
2.9 Where a party assigns an interest under a tenancy agreement so that two or more persons separately hold partial interests and the obligation that is breached

(a) can be apportioned between the separated interests, the obligation is divisible between the separated interests and will accompany each interest, notwithstanding that it is a condition or confers a right of re-entry;

(b) cannot be apportioned between the separated interests, the persons who hold the partial interests are, notwithstanding anything in this Act, jointly and severally liable for the breach.

Continuing right of assignor to sue
2.10(1) Subject to subsection (2), where a party assigns any interest under a tenancy agreement, the assignor may sue the other party or any assignee of the other party for

(a) damages for breach of any of that party's obligations that commences or is committed prior to the date of assignment while the assignor was the landlord or tenant, as the case may be; or

(b) arrears of rent incurred prior to the date of assignment while the assignor was the landlord.

Limited damages for continuing breach
2.10(2) Where an assignor sues under subsection (1) for a continuing breach, the assignor may recover damages or arrears of rent, as the case may be, only for that part of the breach that is committed in regard to that interest prior to the date of assignment.

Assignee's Entitlement to Benefits
and Assumption of Obligations

Benefits and obligations of assignee
2.11(1) A person who takes an assignment of any interest from a landlord or tenant is entitled to all the benefits and assumes all the obligations of the assignor with respect to that interest that

(a) are contained in the tenancy agreement; and

(b) wholly or partially arise subsequent to the date of assignment.

All benefits and obligations run
2.11(2) Without limiting its generality, subsection (1) applies to a benefit or obligation notwithstanding that it

(a) does not touch, concern or have reference to the subject matter of the tenancy agreement;

(b) is a personal service obligation; or

(c) relates to something not in existence at the time the tenancy agreement was entered.

Assignment of arrears
2.12 Where any original or assignee landlord assigns to an assignee landlord an interest in the tenancy agreement and entitlement to enforce any breach which occurs prior to the assignment, that assignee landlord is entitled to enforce any remedy that the assignor could have enforced in respect of the breach, including the rights of re-entry and forfeiture.

Assignee's right to sue for continuing breach
2.13 Where a party commits a continuing breach, an assignee of the other party may sue the wrongdoer for rent or damages or may enforce the right of re-entry or forfeiture, as the case may be, in respect of that part of the continuing breach that occurs after the date of assignment.

Transitional"

Application of new Division
2.14(1) This Division applies to every tenancy agreement entered on or after the coming into effect of this Division.

Continuation of former provisions
2.14(2) Sections 3 to 8 of The Landlord and Tenant Act as enacted immediately prior to the coming into force of this Division continue to apply to every tenancy agreement entered before the coming into effect of this Division.

Eventual application to all
2.14(3) Notwithstanding subsection (2), commencing twenty-five years after the date on which this Division comes into effect, this Division applies to all tenancy agreements regardless of when they are entered.

6 The heading "DIVISION II" *is added before the heading* "SUB-LESSEE AND TITLE TO REVERSION" *that precedes section 9.*

Coming into force
7 This Act comes into force on a day fixed by proclamation.

APPENDIX B

SECTIONS 3 TO 8 OF *THE LANDLORD AND TENANT ACT*, C.C.S.M. c. L70, AND THEIR ORIGINS

PART I
LEASES AND TENANCIES

COVENANTS RUNNING WITH REVERSION

Origin

Remedies accrue to assignee of reversion.
3 All persons being grantees or assignees of the Queen, and the heirs, executors, successors and assigns of every of them, shall have and enjoy like advantage against the lessees, their executors, administrators, and assigns, by entry for non-payment of the rent, or for doing of waste, or other forfeiture, and also shall have and enjoy all and every like and the same advantage, benefit, and remedies, by action only, for not performing of other conditions, covenants, or agreements, contained and expressed in the indentures of their leases, demises, or grantees, their executors, administrators, and assigns as the lessors or grantors themselves, or their heirs or successors, might have had and enjoyed at any time or times.

Section 3 is derived from the *Grantees of Reversions Act, 1540* (Eng.), 32 Henry 8, c. 34, s. 1 (also known as the *Statute of Reversions of Henry VIII*).

Lessee's covenants to run with reversion.
4 Rent reserved by a lease and the benefit of every covenant or provision therein contained, having reference to the subject matter thereof, and on the lessee's part to be observed or performed, and every condition of re-entry and other conditions therein contained shall be annexed and incident to, and shall go with, the reversionary estate in the land or in any part thereof, immediately expectant on the term granted by the lease, nowithstanding severance of that reversionary estate, and

Section 4 is derived from the *Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20, ss. 141(1) and 141(2), which are, in turn, derived from the *Conveyancing and Law of Property Act, 1881* (U.K.), 44 & 45 Vict., c. 41, s. 10(1).

shall be capable of being recovered, received, enforced and taken advantage of by any person from time to time entitled, subject to the term, to the income of the whole or any part, as the case may require, of the land leased.

Right of forfeiture before disposition.

5 The benefit of every condition of re-entry or forfeiture for a breach of any covenant or condition contained in a lease, extends to, and may be enforced and taken advantage of, by the person from time to time entitled, subject to the term, to the income of the whole or any part, as the case may require, of the land leased, although that person became, by conveyance or otherwise, so entitled after the condition of re-entry or forfeiture had become enforceable.

Section 5 is derived from the *Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20, s. 141(3), which is, in turn, derived from the *Conveyancing Act, 1911* (U.K.), 1 & 2 Geo. 5, c. 37, s. 2(1).

Remedies apply against assigns of grantor.

6 All lessees and grantees of lands, tenements, rents, portions, or any other hereditaments for term of years, life or lives, their executors, administrators, and assigns shall and may have like action, advantage, and remedy against all and every person who shall have any gift or grant of the Queen, or of any other persons, of the reversion of the same lands, tenements and other hereditaments so let, or any parcel thereof, for any condition, covenant, or agreement, contained or expressed in the indentures of their leases as the same lessees or any of them, might and should have had against their lessors, and grantors, heirs, or successors.

Section 6 is derived from the *Grantees of Reversions Act, 1540* (Eng.), 32 Henry 8, c. 34, s. 2 (also known as the *Statute of Reversions of Henry VIII*).

Lessor's covenants to run with reversion.

7 The obligation of a covenant entered into by a lessor with reference to the subject matter of the lease shall, if and as far as the lessor has power to bind the reversionary estate immediately expectant on the term granted by the lease, be annexed and incident to, and shall go with, that reversionary estate, or the several parts thereof, notwithstanding severance of that reversionary estate, and may be taken

Section 7 is derived from the *Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20, s. 142(1), which is derived, in turn, from the *Conveyancing and Law of Property Act, 1881* (U.K.), 44 & 45 Vict., c. 41, s. 11(1).

advantage of and enforced by the person in whom the term is from time to time vested by conveyance, devolution in law, or otherwise; and, if and as far as the lessor has power to bind the person from time to time entitled to that reversionary estate, such obligation may be taken advantage of and enforced against any person so entitled.

APPORTIONMENT OF CONDITION OF RE-ENTRY

Apportionment on severance.
8(1) Notwithstanding the severance by conveyance, surrender, or otherwise, of the reversionary estate in any land comprised in a lease, and notwithstanding the avoidance or cessor in any other manner of the term granted by a lease as to part only of the land comprised therein, every condition or right of re-entry, and every other condition contained in the lease, shall be apportioned, and shall remain annnexed to the severed parts of the reversionary estate as severed, and shall be in force with respect to the term whereon each severed part is reversionary, or the term in any land which has not been surrendered, or as to which the term has not been avoided or has not otherwise ceased, in like manner as if the land comprised in each severed part, or the land as to which the term remains subsisting, as the case may be, had alone originally been comprised in the lease.

Application of section 5, 7 and 8.
8(2) Sections 5 and 7, and section 8, so far as it is applicable to leases not made by deed, apply only to leases made after April 1, 1931.

Subsection 8(1) is derived from the *Law of Property Act, 1925* (U.K.), 15 & 16 Geo. 5, c. 20. s. 140(1), which is derived, in turn, from the *Conveyancing and Law of Property Act, 1881* (U.K.), 44 & 45 Vict., c. 41, s. 12(1).

REPORT ON COVENANTS IN COMMERCIAL TENANCIES

EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

The Manitoba Law Reform Commission's Report on *Covenants in Commercial Tenancies* recommends that the law concerning covenants in commercial tenancies should be reformed, simplified and made certain in a manner that is fair to both landlords and tenants and their assignees.

BACKGROUND

Every lease, whether it is a commercial lease or a residential lease, contains covenants. Covenants are promises which are made by a landlord to the tenant or by a tenant to the landlord. For example, a tenant will usually promise to pay the rent throughout the term of the lease, while a landlord may promise to repair the premises. Most covenants are specifically expressed in the lease. However, a few covenants, such as a tenant's promise to pay rent, will be implied to be a part of a lease if it is not specifically expressed in the lease.

CLARIFICATION AND MODERNIZATION OF STATUTE

The rules which govern covenants in commercial leases are contained in the common law and in sections 3 to 8 of *The Landlord and Tenant Act.* The statutory provisions are expressed in ancient, arcane and verbose language which makes them difficult to understand, even by lawyers. The Commission recommends that these provisions should be rewritten in modern, clear and simpler language. Some of the rules which govern covenants in commercial tenancies are inconsistent or needlessly complex and the Commission also makes a number of specific recommendations for their reform.

LIABILITY OF ORIGINAL LANDLORD AND TENANT

A landlord and tenant who enter into a lease are bound to perform their respective obligations until the term of the lease ends, unless they agree otherwise. This means that an original landlord or tenant may be called upon to perform an obligation many years after he or she assigns the lease interest, even without his or her assignee breaching the obligation. Although an original party who pays for a breach of covenant of his or her assignee is entitled to be indemnified, this right is of limited practical value because the insolvency of the defaulting assignee is the usual reason for a party to seek recourse against the original assignor. It is also possible that the obligations of an original landlord or tenant after an assignment will be greater than those contemplated in the lease, as an assignee can vary the lease by agreement with the remaining party without the knowledge or consent of the party who made the assignment.

In practice, the continuing liability principle more commonly affects tenants, since tenants usually undertake many more obligations than do landlords and since landlords generally hold the superior bargaining position in lease negotiations. In order to achieve greater fairness for tenants, the Commission recommends that an original tenant should be liable for breaches which occur after an assignment only as a guarantor. This means that an original tenant would be liable only for obligations contemplated in the original lease and only after the assignee defaults.

The Commission proposes that the principles of the law of guarantee should be adopted to define the continuing liability of the assigning tenant, except that an original tenant should not be released from liability if the tenant's assignee becomes bankrupt and the assignee's trustee in

bankruptcy disclaims the lease. This would give effect to the Commission's intention to subordinate but not eliminate the continuing liability of original tenants.

DISTINCTIONS BETWEEN COVENANTS

The assignees of tenants and landlords benefit from or are obligated by the covenants made by their assignors when certain rules are met. A covenant will benefit or obligate an assignee if it touches and concerns the land; if it does not (such as a covenant to pay taxes on property which is unrelated to the lease premises) it will not affect the assignee. If a covenant of a tenant concerns something which does not yet exist when the lease is made (for example, a building which is not yet built), it will not obligate the tenant's assignee unless the lease specifically mentions the assignee. Furthermore, a landlord and tenant may intend that a particular "personal service" obligation should be performed by one of them, even after that party no longer holds a lease interest; in this case, the assignee would not become liable for that obligation.

The complexity of and lack of apparent reason for these rules prevent many parties to a lease from having a real understanding of the law that governs their relationship and leaves the parties and their assignees in a state of uncertainty concerning their rights and obligations. They are a trap for the unwary. The rule that a personal service obligation remains the obligation of the promisor is problematic when the intentions of the landlord and tenant are not clearly apparent in the lease.

In order to simplify the law, make it more rational and understandable to commercial landlords and tenants, meet the reasonable expectations of landlords and tenants and allow the parties to a lease to be certain of their lease obligations, the Commission proposes to eliminate the distinctions which govern whether a covenant will benefit or obligate an assignee. The Commission recommends that, unless a landlord and tenant agree otherwise, a promise in a lease should benefit or obligate the assignee of the lease interest. This recommendation will eliminate the need to determine whether a landlord's or tenant's promise touches and concerns the lease property, whether it is a personal service covenant and whether it pertains to a matter which is in existence when the lease is made.

LIABILITY OF ASSIGNEES OF LANDLORD AND TENANT

When a breach of a covenant is commenced by a landlord or tenant and continued by that party's assignee, the assignee is ultimately liable for the entire breach. The Commission considers that this does not accord with the expectations of most individuals. Instead, the Commission believes that most individuals expect that each party would be ultimately responsible for any part of a breach which occurs while he or she is the landlord or tenant - that is, while he or she benefits from the lease interest - and that the law should be changed accordingly. Although this change will mean that courts will have to apportion liability for a continuing breach between an assignor and his or her assignee, the change will achieve greater simplicity in the rationale of the law and greater fairness to the parties by having the losses remain with those who are responsible for them.

RIGHT TO ENFORCE COVENANTS

A tenant who assigns a lease interest remains entitled to sue the landlord for the part of a breach which was committed prior to the assignment. An assignee of a tenant is entitled to sue the landlord for the part of a breach which occurs after the assignment to himself or herself. However, when a tenant registers an assignment pursuant to *The Real Property Act*, the assignee becomes entitled to sue the landlord for breaches committed prior to the assignment.

However, the rules differ for landlords and their assignees. A landlord who assigns a lease interest retains an entitlement to sue the tenant for breaches which were committed in their entirety prior to the assignment but, if a breach continues after the assignment, the landlord loses the right to sue. The landlord also loses any entitlement to enforce a right of forfeiture or re-entry which had accrued to him or her prior to the assignment. At the same time, an assignee of a landlord is entitled to sue the tenant not only for the portion of a continuing breach which occurs after the assignment, but also for the part of the breach which occurred prior to the assignment. In addition, an assignee of a landlord is entitled to enforce a right of re-entry or forfeiture which accrued to the landlord prior to the assignment and which was unexercised.

The Commission notes that the Manitoba law is difficult to reconcile with the English cases which interpret similar legislation and also notes that the existing rules are not clear about the rights of the landlord and landlord's assignee in respect to one another. For example, it is not clear whether the original landlord and assignee can concurrently seek to enforce their respective entitlements to arrears of rent and re-entry. The Commission also notes that different rules pertain to landlords and tenants and that there is no apparent reason of policy for these differences.

The Commission proposes that these problems should be addressed by eliminating the differences which exist for landlords and tenants. Entitlement to sue should relate to the right to receive the benefits of a lease interest. Landlords, tenants and their assignees should be entitled to sue for breaches or portions of breaches which occur while they hold their respective lease interests. A person should retain that entitlement to sue even after he or she assigns a lease interest whether or not the assignment is registered pursuant to *The Real Property Act*.

CONTRACTING OUT

The present provisions of *The Landlord and Tenant Act* which concern covenants in commercial tenancies operate only to the extent that the parties do not address a situation in their lease. Generally, the Commission wishes to retain the right of landlords and tenants to negotiate the terms of their leases between themselves. However, the Commission believes that one exception to this right is necessary. The Commission proposes that the parties should not be allowed to increase the liability of the original tenant after an assignment by the tenant from secondary liability as a guarantor for the duration of the term in the original lease (or an extended period, if the original tenant has exercised an option to extend the term).

IMPLEMENTATION

The Commission believes that it would be unfair for its recommendations to apply to landlords and tenants who have already entered into leases, especially given the recommendation that all covenants in a lease should benefit or obligate the assignees of the parties (unless the parties expressly specify otherwise in their lease). To avoid any unfairness, the Commission proposes that the new rules should apply only to new leases and that the old rules should continue to apply to existing leases. However, two sets of rules should not apply to different leases at the same time for an indefinite period of time. There, the Commission proposes that legislation implementing the recommendations for reform in this Report should apply to all commercial leases entered into after it comes into force and to all commercial leases, regardless of when they are entered into, twenty-five years after that date.

SOMMAIRE DU RAPPORT SUR

LES ENGAGEMENTS EN MATIÈRE DE LOCATIONS COMMERCIALES

Dans son rapport intitulé *Covenants in Commercial Tenancies*, la Commission de réforme du droit du Manitoba recommande que soit réformé, simplifié et clarifié le droit portant sur les engagements en matière de locations commerciales, de sorte qu'il soit juste aussi bien pour les locateurs et les locataires que pour leurs cessionnaires.

RENSEIGNEMENTS GÉNÉRAUX

Chaque bail, qu'il s'agisse d'un bail commercial ou résidentiel, comporte des engagements, c'est-à-dire des promesses faites par le locateur au locataire ou par le locataire au locateur. Par exemple, le locataire s'engage habituellement à payer le loyer pendant toute la durée du bail alors que le locateur peut s'engager à réparer les locaux. La plupart des engagements sont explicités dans les baux. Toutefois, certains engagements, comme celui de payer le loyer, sont considérés comme faisant partie implicite des baux s'ils n'y sont pas explicités.

CLARIFICATION ET MODERNISATION DE LA LOI

Les règles régissant les engagements pris dans le cadre de baux commerciaux sont énoncées dans la common law et dans les articles 3 à 8 de la *Loi sur le louage d'immeubles*. Les dispositions de la version anglaise de cette loi sont rédigées dans un style archaïque, vieilli et verbeux qui fait qu'elles sont difficilement compréhensibles. Même les avocats ont du mal à les comprendre. La Commission recommande que ces dispositions soient récrites dans un langage moderne, clair et limpide. Certaines règles s'appliquant aux engagements en matière de locations commerciales sont incohérentes ou inutilement compliquées. La Commission formule donc un certain nombre de recommandations précises en vue de leur réforme.

OBLIGATIONS DES LOCATEURS ET DES LOCATAIRES INITIAUX

Le locateur et le locataire qui concluent un bail sont tenus de s'acquitter de leurs obligations respectives jusqu'à la fin du bail, à moins d'entente contraire. Ainsi, un locateur ou un locataire initial pourrait être appelé à s'acquitter d'une obligation de nombreuses années après la cession de son intérêt dans le bail, sans qu'il y ait manquement à l'obligation en question de la part de son cessionnaire. Bien que la partie initiale qui paie pour une rupture de contrat de la part de son cessionnaire ait le droit de se faire indemniser, ce droit a peu de valeur dans les faits puisque c'est habituellement l'insolvabilité du cessionnaire qui amène l'autre partie à obtenir réparation auprès du cédant initial. Il est également possible que les obligations du locateur ou du locataire initial soient plus grandes après une cession que celles prévues dans le bail, car le cessionnaire peut, avec le consentement de l'autre partie, modifier le bail à l'insu ou sans le consentement de la partie cédante.

Dans les faits, le principe de la responsabilité continue touche plus souvent les locataires puisqu'il leur est habituellement dévolu beaucoup plus d'obligations qu'aux locateurs qui ont généralement le beau rôle en matière de négociation des baux. Par souci d'une plus grande équité pour les locataires, la Commission recommande que les locataires initiaux soient tenus responsables, uniquement à titre de cautions, des ruptures de contrat qui se produisent après la cession des baux. Ainsi, les locataires initiaux seraient tenus responsables uniquement pour les obligations prévues dans les baux initiaux, seulement après un manquement de la part des cessionnaires.

La Commission propose que l'on se fonde sur les principes de la loi de garantie pour définir la responsabilité continue des locataires cédants, pour autant que ces derniers ne soient pas soustraits à leurs responsabilités lorsque leurs cessionnaires déclarent faillite et que les syndics de faillite répudient les baux, ce qui donnerait effet à l'intention de la Commission de subordonner, mais non d'éliminer, la responsabilité continue des locataires initiaux.

DIFFÉRENCES ENTRE LES ENGAGEMENTS

Les bénéfices et les obligations découlant d'engagements sont dévolus aux cessionnaires des locateurs et des locataires cédants pour autant que certaines règles soient respectées. Ces bénéfices et obligations leur sont dévolus si les engagements ont trait ou se rapportent à un bien-fonds. S'ils ne s'y rapportent pas (comme un engagement à payer les impôts fonciers sur des biens qui n'ont rien à avoir avec les biens donnés en location), ils ne touchent pas les cessionnaires. Les engagements portant sur des biens n'existant pas au moment de la signature des baux (par exemple, un bâtiment qui n'est pas encore construit) n'ont pas pour effet d'imposer des obligations aux cessionnaires des locataires à moins que les cessionnaires soient expressément nommés dans les baux. De plus, il peut arriver qu'un locateur et qu'un locataire veulent qu'une obligation de service personnel soit imposée à l'un d'entre eux, même après la cession de leur intérêt dans le bail. En pareil cas, l'obligation en question n'est pas dévolue au cessionnaire.

La complexité et le manque de logique apparent de ces règles empêchent bon nombre de parties à des baux de se faire une idée claire du droit qui régit leurs rapports et laissent les parties et leurs cessionnaires dans l'incertitude en ce qui concerne leurs droits et leurs obligations. Il s'agit d'un piège pour les personnes qui ne sont pas sur leurs gardes. La règle voulant que l'obligation de service personnel demeure la responsabilité du promettant se révèle problématique lorsque les intentions du locateur et du locataire ne sont pas claires dans le bail.

Afin de simplifier la loi, de la rendre plus logique et plus compréhensible pour les locateurs et les locataires commerciaux, de répondre aux attentes légitimes des locateurs et locataires et d'éliminer l'incertitude quant aux obligations des locateurs et locataires, la Commission propose d'éliminer les distinctions entre les bénéfices et les obligations dévolus au cessionnaire d'un engagement. La Commission recommande que le bénéfice ou les obligations d'un bail soient dévolus au cessionnaire du bail, à moins qu'une entente contraire n'intervienne entre le locateur et le locataire. Cette recommandation vise à éliminer le besoin de déterminer si la promesse d'un locateur ou d'un locataire touche les biens loués, s'il s'agit d'un engagement de service personnel et s'il se rapporte à un bien qui existait au moment de la signature du bail.

OBLIGATIONS DES CESSIONNAIRES DES LOCATEURS ET DES LOCATAIRES

Lorsque la violation d'un engagement est initiée par un locateur ou un locataire et qu'elle est poursuivie par leur cessionnaire, ce dernier est responsable au bout du compte pour toute la violation. La Commission est d'avis que ceci ne concorde pas avec les vues de la majorité. Au contraire, la Commission estime que la plupart des personnes s'attendent à ce que chaque partie soit tenue responsable de la partie de la violation qui a été commise alors qu'elle était locateur ou locataire, c'est-à-dire alors qu'elle détenait le bénéfice de l'intérêt du bail, et que la loi devrait être modifiée en conséquence. Bien que cette modification signifie que les tribunaux auront à répartir la responsabilité entre le cédant et son cessionnaire dans les cas de violation continue, elle permet de simplifier la loi et de la rendre plus juste pour les parties en faisant retomber la responsabilité des pertes sur ceux qui en sont responsables.

DROIT DE FAIRE RESPECTER LES ENGAGEMENTS

Le locataire qui cède son intérêt dans un bail conserve son droit d'intenter des poursuites contre le locateur à l'égard de la rupture de contrat qui a eu lieu avant la cession. Quant au cessionnaire, il a le droit de poursuivre le locateur pour la rupture de contrat survenue après qu'il a obtenu la cession. Par contre, le cessionnaire du locataire qui fait enregistrer la cession en vertu de la *Loi sur les biens réels* obtient le droit de poursuivre le locateur pour les ruptures de contrat survenues avant la cession.

Toutefois, les règles diffèrent pour les locateurs et les cessionnaires. Le locateur qui cède son intérêt dans un bail conserve le droit de poursuivre le ou les locataires pour toute rupture de contrat survenue entièrement avant la cession. Par contre, si la rupture se prolonge après la cession, il perd son droit de poursuivre. Il perd également son droit de faire respecter le droit de déchéance ou de reprise de possession qu'il a acquis avant la cession. De son côté, le cessionnaire du locateur a le droit de poursuivre le locataire non seulement pour la rupture de contrat survenue après la cession, mais aussi pour la rupture de contrat survenue avant la cession. En outre, il peut faire respecter le droit de reprise de possession ou de déchéance que le locateur a acquis avant la cession et qu'il n'a pas exercé.

La Commission remarque que la loi manitobaine est difficile à réconcilier avec l'interprétation qui est donnée à des lois similaires dans la jurisprudence anglaise. Elle remarque également que les règles actuelles ne sont pas claires en ce qui concerne les droits des locateurs et des cessionnaires. Par exemple, il n'est pas clair si le locateur initial et son cessionnaire peuvent faire valoir concurremment leurs droits respectifs en matière d'arriérés de loyers et de reprise de possession. La Commission remarque également que des règles différentes s'appliquent aux locateurs et aux locataires et que rien ne semble justifier ces différences.

La Commission propose que l'on règle ces problèmes en éliminant les différences dans les règles qui s'appliquent aux locateurs et aux locataires. Le droit de poursuivre devrait découler du droit au bénéfice de l'intérêt dans le bail. Les locateurs, les locataires et leurs cessionnaires devraient pouvoir poursuivre pour des ruptures entières ou partielles de contrat qui surviennent pendant qu'ils ont un intérêt dans le bail. Ils devraient de plus conserver ce droit de poursuivre même après la cession d'un intérêt dans le bail, que cette cession soit ou non enregistrée en vertu de la *Loi sur les biens réels*.

ACCROISSEMENT DES OBLIGATIONS DU LOCATAIRE INITIAL

Les dispositions actuelles de la *Loi sur le louage d'immeubles* qui ont trait aux engagements en matière de locations commerciales sont applicables pour autant que les parties ne tentent pas de remédier à une situation prévue dans leur bail. En règle générale, la Commission souhaite que soit conservé le droit des locateurs et des locataires de négocier les dispositions des baux qu'ils concluent. Toutefois, elle estime qu'il faut prévoir une exception à cette règle. Elle propose qu'il soit interdit aux parties d'accroître les obligations du locataire initial après une cession, à partir du moment où ce dernier n'est lié qu'accessoirement à titre de caution jusqu'à l'expiration du bail initial (ou jusqu'à la fin de la période de prolongation du bail initial, le cas échéant).

APPLICATION

La Commission estime qu'il serait injuste pour les locateurs et les locataires que ses recommandations s'appliquent aux baux déjà en vigueur, surtout la recommandation voulant que tous les bénéfices et les obligations découlant d'un bail soient dévolus aux cessionnaires (à

moins de stipulation contraire dans le bail). Afin d'éliminer toute injustice, la Commission propose que les nouvelles règles ne s'appliquent qu'aux nouveaux baux et que les anciennes règles continuent à s'appliquer aux baux en vigueur.

Toutefois, il ne faudrait pas que deux jeux de règles différents s'appliquent aux baux pendant une période de temps illimité. A cette fin, la Commission propose que la loi ayant pour fonction de donner suite aux recommandations formulées dans le présent rapport s'applique à tous les baux de location commerciale conclus après son entrée en vigueur ainsi qu'à tous les baux de location commerciale, peu importe leur date d'entrée en vigueur, vingt-cinq ans après son entrée en vigueur.