Darrell Gold LLB
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When is a 'Default' not a 'Default'?

This article has been contributed by Darrell Gold LLB with Robins Appleby & Taub LLP

When a lease defines an "event of default "or "default" as being a failure to meet monetary or non-monetary obligations on or before the expiry of a cure period, and the defaulting party has rights that are predicated on not being in default at the time of exercise (such as a right to extend), then landlords and tenants must understand the ramifications arising from the interaction of these provisions when a party purports to exercise an option or right.

This issue, along with a number of other related ones, was material to the September 2011 decision in Ontario involving Firkin Pubs Metro Inc. as tenant and Flatiron Equities Limited as landlord. The lease term was for 10 years beginning January 1, 2001 and ending December 31, 2010, and contained an option to extend for two five-year terms. On April 7, 2010, an officer and director of The Firkin Hospitality Group Inc. (not the tenant) wrote to the landlord's agent confirming the tenant's intention to exercise the option to extend the lease for five years. The option to extend provision in the lease provided for the new base to be agreed upon failing which it was to be determined by arbitration. Negotiations between the parties continued into 2011.

On April 26, 2011, the landlord served a notice of default on the tenant (for failure to pay additional rent adjustments relating to 2008) with a 15 day cure period. After the April 26, 2011 default notice but during the cure period, the tenant paid the rent claimed. On May 20, 2011, the landlord asserted that the tenant's April 7, 2010 exercise of its extension option was not valid due to the alleged rent default by the tenant existing at the time of exercise. The tenant was told to deliver vacant possession of the premises (the premises was also licensed to the tenant's franchisee since the beginning of the term).

The tenant asked the Ontario court for a declaration that the extension option had been validly exercised, and an order compelling the landlord to arbitrate the basic rent amount in accordance with the lease. The application was allowed.

The Court held that even if there were a rent default by the tenant, the option to extend provided that a default constituted an "event of default" only when it remained un-remedied after the time specified in the landlord's April 26, 2011 notice of default and in accordance with the definition of "event of default" in the lease. The alleged breach, therefore was not an "event of default" at the time of the exercise of the extension option on April 7, 2011 (and notwithstanding that the landlord sent an invoice to the tenant on September 7, 2009 for 2008 rent adjustments as the court held that such a letter was merely a "request for payment" and not a notice of default with a cure period). As a result, there was no "event of default" to invalidate the tenant's exercise of the extension option and the parties were ordered to arbitrate the new base rent.

The Lesson: Many landlord lease forms, even those of national landlords, define an "event of default" as only occurring after written notice to and the expiry of a curative period without cure by the tenant. That clearly means that until such a notice is given and the curative period provided expires without cure, the tenant's rights or options that are predicated (in whole or in part) on not being in default at the time of exercise continue to be validly exercisable after the notice of default until expiry of the cure period. If a landlord wants to try and avoid that result, then clear lease language to the contrary would be necessary. For example the following could be added to a standard form of lease as part of the "default" definition or section: "Notwithstanding anything in this lease, at law or equity, until such time as the event of default has been fully cured, then no option to extend, or transfer right in favour of the tenant shall be validly exercisable."