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The Obligation to Return a Tenant's Deposit

The Importance of a Properly Worded Rental Application

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The July 2011 decision of the Ontario Court of Appeal in the case of *Musilla v. Avcan Management Inc.*, clarified the law regarding a landlord's obligation to return a tenant's deposit for last months rent (pursuant to section 107 of the Residential Tenancies Act, Ontario) and the circumstances when a landlord's is entitled to keep the deposit.

In *Musilla*, the tenant's rental application for a one (1) year lease was accepted by the landlord and the deposit for one month's rent was paid. However, six weeks before the commencement date, the tenant advised the landlord she would not take possession and requested return of the deposit. Two (2) weeks later, the landlord refused but said it was still prepared to give her possession which the tenant did not accept. The Landlord was unable to re-rent the premises until 2 months after the possession date. The Tenant applied to the Landlord and Tenant Board for return of the deposit and was denied on the application and on appeal to the Divisional Court. She appealed to the Court of Appeal who found in her favour and ordered the return of the deposit together with her legal costs.

Section 107 of the Act provides for the return of the deposit where possession "is not given" to the tenant i.e. the Landlord refuses or is unable to provide possession. The Court held that the wording of section 107 is a fair result where a landlord is unable or unwilling to provide possession.

However, the Court held that section 107 does not apply where a tenant has refused to accept possession from a willing landlord, in which event a landlord may retain the deposit provided the following are satisfied:

- A. the deposit was accepted solely as security for last months rent (as expressly stated in s.105(1) and 106(10) of the Act) and not as security for any other tenant obligation.
- B. the landlord mitigates (minimizes) its damages by re-renting the premises but still suffers a loss of rent.

Thus, if the deposit was not expressly accepted and held for last months rent or the landlord was able to mitigate its damages fully, then the Landlord would likely have to return the deposit to a tenant – even in a situation where the tenant voluntarily chose not to move in, as in the *Musilla* case.

In *Musilla*, even though the landlord was able to give possession to the tenant, it was ordered to return the deposit because the Court found that the rental application was confusing as it was not clear that the deposit was only to be used as security for the payment of last months rent and not for any other breaches (such as the tenant's failure to sign a tenancy agreement). In addition, the deposit clause also provided for forfeiture of the deposit on failure to sign a tenancy agreement and the Court held that was illegal as it was contrary to the Act. As a result, the landlord had to refund the deposit and pay the tenant's legal costs of \$7,000.00 - (which probably exceeded the deposit amount by a large amount).

The Lesson: It's prudent to review your standard tenancy agreement forms at least annually to address any deficiencies based on recent case law or statutory changes. As a result of *Musilla*, ensure that the deposit wording reflects the deposit's use for last months rent and not as security for other breaches. If a tenant fails to take possession of premises when ready or fails to sign a tenancy agreement, the wording should provide that the deposit remains held as security for the last months rent obligation (and is not forfeited) until such time as the landlord has fully mitigated its rent damages for the tenant's default. Remember that if your wording is ambiguous or illegal (i.e. forfeiture of the deposit), it will affect every tenant who signed the form and that can result in the loss of more than just one deposit plus payment of legal costs.

"A proactive approach is typically more cost effective than a reactive one"

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