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Pitfalls in enforcement of indemnities

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Landlords need to incorporate language in their lease and assignment documents to address expected rental increases at the time of extensions.

A recent decision of the Ontario Superior Court of Justice has cast doubt on a landlord's ability to enforce indemnities provided in the course of the assignment of commercial leases. The decision highlights pitfalls for landlords attempting to recover against prior assignors (and their principals) if consent to material changes to the lease (such as rent) is not obtained and the language of the indemnity does not adequately address the point.

This article examines the decision in *1212763 Ontario Ltd. v. Bonjour Café* and provides some views on provisions landlords should consider incorporating into assignment agreements to strengthen the enforceability of such indemnities.

Facts

The predecessor of 1212763 Ontario Limited (the "Landlord") leased a unit in a building to Bonjour Café for a term of five years commencing in February 1996 (the "Lease"). With the Landlord's consent, the Lease was assigned to 1312215 Ontario Inc. ("131") in 1998, and was extended at or around that time for a further five years to February 2006 (the "First Extension").

Over the course of the next few years, the Lease was successively assigned to four new tenants after 131. In 2004, the final assignee tenant extended the Lease for three more years to February 2009. That tenant also negotiated an increase in rent to $32, $33 and $34 per square foot in the first, second and third years of the extension (the "Second Extension").

The base rent for 2005-2006, the final year of the First Extension period of the Lease, was $30 per square foot. That rent reflected an annual $1 per square foot increase since the first year of the First Extension period being 2001-2002.

Landlord's claims

The final assignee tenant stopped paying rent in July 2005 and the Lease was terminated. The Landlord found a new tenant at a lower rent and brought an action for recovery of unpaid rent and the difference in the rental amounts for the mitigation period.

The trial only proceeded against 131 and one of the subsequent assignee tenants, Café Ebenezer ("Ebenezer"), as well as their principals, both of whom had executed indemnities agreeing to be jointly and severally bound with the corporate tenants. The other tenants were not pursued as they either could not be found or it was decided that it was not worth it.

Liability and indemnification

With respect to 131, under the terms of the Consent to Assignment, it remained obliged to pay rent under the Lease notwithstanding the assignment, and its principal's accompanying indemnity remained in effect until the *end of the term of the Lease* which, at the time, was February 2006 on account of the First Extension.

With respect to Ebenezer, it also remained liable for rent due under the Lease under the terms of the Consent to Assignment. Its principal had executed a Supplementary Indemnity that remained in effect until the end of the term of the Lease and *any extensions thereof*.

At that time, the term of the Lease expired in February 2006; but, under the Second Extension, the lease was subsequently extended to February 2009 by the final tenant. No notice of this assignment or the extension was provided to 131, Ebenezer or their principals.

No liability for second extension

Although the court appears to have had no difficulty in finding the defendants liable for rent up to the end of the First Extension period (i.e., February 2006), it did not find any of the defendants liable for the Second Extension period (i.e., between February 2006 to February 2009).

The finding was straightforward for 131 and it principal since, under the terms of the Consent to Assignment and indemnity, their obligations clearly expired at the end of the term of the Lease which, at the time, was February 2006. For Ebenezer and its principal, the situation was significantly different on account of the additional wording: "*...any extensions thereof*." But, the increased rent for the extension period was a critical factor in the court's analysis.

No consent to rent increase

The court framed the issue as follows: was the Landlord permitted to extend the Lease beyond February 2006 at an increased rate without the consent of Ebenezer and its principal? The court found that Ebenezer's and its principal's liability would have continued had the Lease simply been extended.

This finding is supported by the clear language of the contract which pre-authorized an extension of the Lease. This portion of the judgment can be fairly interpreted to mean that for the narrow purpose of simply extending the Lease, neither notice nor consent would have been required.

In this regard, the court relied on a line of mortgage cases in which extensions of term without notice were accepted because the extensions were negotiated at the same or lower costs. However, the court found that since the indemnities signed by Ebenezer and its principal did not

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address the *cost* of an extended term, the increased rent negotiated for the Second Extension period was beyond the scope of the contract.

The consent of Ebenezer and its principal was required for the increased rent. Since it was not obtained, the court found that the indemnities were terminated in February 2006.

Significance

The result in this case may be of concern for some landlords attempting to enforce indemnities. Despite the clear language in Ebenezer's principal's Supplementary Indemnity that he remain liable "notwithstanding any extensions," the court held that the indemnity terminated *before* the Second Extension took effect.

As a result, Ebenezer's principal was not liable for any sum for the Second Extension period. Why, then, was Ebenezer's principal not held liable at least for rent reasonably contemplated for an extension, which likely would have been the $30 per square foot base rent for the final year of the Lease's First Extension period?

The court addressed this question by stating that termination,

> is the effect of the application of the common law rules. The amendments are not to be read as if the Landlord extended the Lease on the same terms and conditions.

Rental increases

This strict interpretation effectively voids the Supplementary Indemnity, as opposed to finding some measure of liability based on what could have been reasonably inferred to have been in the parties' contemplation in terms of rent for an extension. This result highlights the need for landlords to incorporate language in their lease and assignment documents that addresses rental increases, which are to be expected to arise at the time of extensions.

A provision in the Ebenezer indemnities that it and its principal would remain liable for fair market value rent at the time an extension took effect might have been sufficient to uphold the indemnity and have allowed the Landlord to recover some measure of its loss over the Second Extension period.

REFERENCES: *1212763 Ontario Ltd. v. Bonjour Café*, 2012 ONSC 823; The mortgage cases include: *Bank of Montreal v. Negin* (1996), 31 O.R. (3d) 321 (C.A.); *Laurentian Bank of Canada v. Laurina Investments Limited*, [1998] O.J. No. 1167 (Gen. Div.), aff'd [1999] O.J. No. 4027 (C.A.); and *Tkachuk v. Boettger*, [2001] O.J. No. 5184 (S.C.).

EMPLOYMENT LAW

Caution advised in social media background checks

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Employers should exercise caution in conducting social media background checks of potential employees.

In March 2011, Randstad's Global Workmonitor survey reported that 77 per cent of Canadian employees have social media accounts and 67 per cent report using those accounts for exclusively personal purposes. This means that three in four Canadian employees are posting personal information online that — depending on the privacy settings used by them — can be reviewed and considered by potential employers.

And, certainly employers are reviewing and considering the information posted about job applicants on social media sites. In fact, a 2009 CareerBuilder survey found that 45 per cent of the 2,600 hiring managers surveyed admitted to checking job applicants' social networking accounts, compared to only 22 per cent in the previous year.

Proposed U.S. legislation

In light of all of this, it is critical for Canadian employers to understand and evaluate the risks of social media background checking. In the United States, concerns over social media background checking have reached virtually crisis proportions.

The media has been abuzz with stories of job applicants who have been asked by interviewers to provide login information to their Facebook and other social media accounts during recruitment so that prospective employers could review the contents of those accounts. A serious outcry about personal privacy has ensued, with some states moving to pass legislation restricting organizations from asking job applicants for access to their social networking accounts.

In April 2012, the United States House of Representatives tabled national legislation, the *Social Networking Online Protection Act*. If passed, the legislation would prohibit employers, schools and universities from requiring usernames and passwords from current or prospective employees and students.

Canadian context

In Canada, the practice of employer requests for login information to applicants' social media accounts appears to be much less common. Currently, there is no law in Canada that expressly prohibits employers from asking for this information, or from conducting social

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