ERRATUM

RE: "Highway Properties — Look Both Ways Before Crossing" Volume 24(3) at 477

1. Page 477 para. 2 line 11, the word "discovery" should read "recovery".

2. Page 478 para. 2, the opening word "and" should read "as".

HIGHWAY PROPERTIES — LOOK BOTH WAYS BEFORE CROSSING*

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This article discusses the impact and effect that the Supreme Court of Canada decision in the Highway Properties case has had on leases and landlord-and-tenant law. The remedies that a landlord has available for breach of a lease are examined as well as the doctrine of surrender by operation of law and the duty to mitigate. The author questions the classification of a lease as a contract versus a conveyance of an estate in land.

I. INTRODUCTION

The judgment of the Supreme Court of Canada in *Highway Properties Ltd.* v. *Kelly, Douglas & Co. Ltd.*[1] is a key decision in the development of Canadian jurisprudence relating to leases generally and the remedies of a landlord in particular. The case was recognized as a landmark decision shortly after the judgment was released. One commentator wrote:[2]

> The Supreme Court of Canada has now armed the modern combatant in landlord-and-tenant litigation with modern weapons. It is unlikely that even the most pacific observer of the jurisprudential battleground will fail to applaud this particular rearmament.

Some of the excitement about the impact of this decision began to wane as subsequent cases interpreted the judgment. A later commentator noted that there were two possible interpretations of the judgment;[3] a broad interpretation which would apply contract principles concerning damages and prospective losses to lease situations without restriction, and a narrower interpretation which would permit the recovery of prospective losses only where there was a continuous use covenant similar to that contained in the Kelly Douglas lease (*Highway Properties* case); repudiation by the tenant; and a proper, contemporaneous notice from the landlord to the tenant. The narrower interpretation would permit this right of discovery to co-exist with the more traditional concepts arising out of estate or conveyance law that had been applied to leases prior to the *Highway Properties* case.

Fourteen years, including the years of recent recession, have now passed since the Supreme Court of Canada issued its decision in *Highway Properties* v. *Kelly, Douglas & Co. Ltd.* This has given the courts a large number of opportunities to consider the case and its implications. While

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* Some of the material and concepts discussed in this article are drawn from a previous article by this author published in the Proceedings of 1983 Mid-Winter Meeting of the Alberta Branch of the Canadian Bar Association entitled "THE FALLOUT FROM HIGHWAY PROPERTIES: TO MITIGATE OR SURRENDER."

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1. (1971) 17 D.L.R. (3d) 710.
2. M. A. Catzman, "Landlord and Tenant, Remedies Available to Landlord When Tenant Wrongfully Repudiates Lease, Property Law or Contract Law, The Demise of *Goldhar* v. *Universal Sections & Mouldings Ltd.*" (1972) 50 *Can. Bar Rev.* 121 at 128.
3. N.H. Schipper, "Damages: Implications of the Kelly, Douglas Case", *Shopping Centre Leases* (H.M. Haber ed. 1976) 655-668.

the decisions individually may seem somewhat hesitant or tenantive, looked at together, they bear witness to an important development in the law relating to leases.

II. HISTORICAL PERSPECTIVE ON LEASES

To appreciate the significance of this legal development requires some understanding of the historical background of leases. Leases were originally chattels or elements of personal property.

> In early times, when leaseholds were regarded as mere contractual rights to occupy land, they were hardly estates at all. But in time, when the law came to give them full protection as proprietary interest, they were added to the list of recognised legal estates.[4]

And is apparent from this comment, the Courts gradually began to recognize the proprietary interest created by a lease and began to afford it protection as an interest in land. This naturally emphasized the lease as conveying an estate or interest in land. Ultimately, leases were added to the list of recognized estates, although categorized as chattels real (still an element of personal property) rather than being treated as real property.

> Leaseholds are still, therefore, personalty in law. But having now for so long been recognized as interests in land and not merely contractual rights, they have been classed under the paradoxical heading "chattels real". The first word indicates their personal nature (cattle were the most important chattels in earlier days, hence the name), the second shows their connection with land. The three types of property may, therefore, be classified thus:
>
> Land { (i) realty;
> Personalty { (ii) chattels real;
> (iii) pure personalty.[5]

With the emphasis upon leases as operating to convey interests or estates in land, doctrines from real property law began to be applied to them, one result of which was that restrictions were placed on remedies available to the parties to a lease. Particularly troublesome in this regard was the doctrine of surrender by operation of law which is one of the central issues considered by the Supreme Court of Canada in the *Highway Properties* case.

III. CANADIAN JURISPRUDENCE PRIOR TO *HIGHWAY PROPERTIES* v. *KELLY, DOUGLAS*

Prior to *Highway Properties*, the decision of the Ontario Court of Appeal in *Goldhar* v. *Universal Sections and Mouldings Ltd.*[6] was regarded as the leading authority with respect to a landlord's options or remedies when a tenant vacated premises before the expiration of the lease term. This case arose from the following facts. The Plaintiff (tenant — sublandlord) had leased premises, which it in turn subleased to the Defendant. The Defendant, having constructed a new building for its business, listed the premises as available for further subletting, but was not successful in finding a subtenant. The Defendant wrote to the Plaintiff alleging certain breaches of the lease on the part of the Plaintiff and

4. Megarry and Wade, *Law of Real Property* (5th ed. 1984) 43.
5. *Id.* at 10-11.
6. (1962) 36 D.L.R. (2d) 450.

indicating that as a result, the Defendant felt the lease was null and void and that they would be vacating. The Plaintiff responded to this by affirming the lease, following which the Defendant delivered the keys to the premises to the Plaintiff and vacated. The Plaintiff attempted to relet the space, but without much success. Consequently, it brought an action claiming the deficiency arising out of the period of time the premises were vacant and the reduced rent which the Plaintiff was forced to accept upon reletting. The Plaintiff was successful at trial before Mr. Justice Gale, who held that the action was not "for rent following the surrender . . . , but rather a simple action for damages for breach of contract based upon the defendant's repudiation of the contract. . . ."[7] This emphasizes the contractual aspects of a lease and relegates the proprietary aspects to lesser importance.

Mr. Justice McGillivray (Justices Gibson and Kelly concurring) on the Ontario Court of Appeal reversed the decision holding in essence, that the Plaintiff had accepted a surrender of the lease and thus was not entitled to any damages following the date of the surrender. Mr. Justice McGillivray noted that "While the modern lease contains numerous contractual provisions it operates primarily to convey a possessory title . . . . Under concepts of property law a lease is primarily a conveyance to which the covenants are incidental."[8]

He goes on to define a surrender by operation of law as one which "occurs when the parties to a lease participate in a course of action inconsistent with the continued existence of the lease".[9] He indicates that situations where this in fact occurs can be categorized into two classes: one where the landlord resumes control of the premises; and the other where the landlord leases to a third party. In either situation the landlord's actions amount to a virtual taking of possession. Mr. Justice McGillivray concludes by indicating that the landlord has three choices of action available to him in the event of the tenant abandoning the premises, that is, he may:

1. maintain the premises vacant until the expiry of the lease and recover rent for the balance of the term;
2. serve a notice upon the tenant that the landlord intends to relet on behalf of the tenant and proceed on that basis; or
3. accept the tenant's offer to surrender the lease by actions which are inconsistent with the continued existence of the lease, permitting the landlord to claim for rental arrears up to the date when surrender is accepted, but for no damages thereafter.

The reasoning of the Ontario Court of Appeal in *Goldhar* was approved by the Alberta Court of Appeal in *Bel-Boys Buildings Ltd.* v. *Clark*,[10] by the Appellate Division of the Nova Scotia Supreme Court in *South End Development Ltd.* v. *E. B. Eddy Co.*,[11] and by the British Columbia Court

7. (1962) 34 D.L.R. (2d) 82 at 93.
8. *Supra* n. 6 at 453.
9. *Id.* at 455.
10. (1967) 59 W.W.R. 641.
11. (1970) 16 D.L.R. (3d) 89.

of Appeal in *Highway Properties Ltd.* v. *Kelly Douglas & Co. Ltd.*[12] It was the appeal from this last mentioned decision that gave the Supreme Court of Canada the opportunity to consider the soundness and cogency of this line of cases.

IV. THE DECISION IN *HIGHWAY PROPERTIES*

Highway Properties was the developer of a shopping centre in North Vancouver, British Columbia. The centre was comprised of approximately 11 stores. Kelly Douglas, operating under the trade name of Super Value, had signed a 15 year lease as the major anchor tenant in the shopping centre. After operating for approximately 17 months, Kelly Douglas decided to close the store, or "go dark" in the jargon of the shopping centre industry. The landlord commenced an action against the tenant seeking: (1) A Declaration that the lease was valid and binding; (2) Specific performance; (3) A mandatory injunction; and (4) Damages. In its Statement of Defence, the tenant expressly repudiated the lease, following which the landlord sent a notice to the tenant indicating that it would retake possession of the premises, attempt to lease them to another party and would be holding the tenant liable for all damages which the landlord suffered. The Statement of Claim was then amended accordingly. The landlord was unsuccessful both at trial[13] and before the British Columbia Court of Appeal[14] (it should be noted, however, that Chief Justice Davey wrote a strong dissent in this latter decision). The matter then came before the Supreme Court of Canada.

The late Chief Justice Laskin (then sitting as a puisne judge) wrote the judgment for the Court composed of himself, Justices Martland, Judson, Ritchie and Spence. He reviewed the state of law in Canada and noted a different trend in the decisions of the English, American, and Australian Courts. The approach of the High Court of Australia in *Buchanan* v. *Byrnes* [15] commended itself to Mr. Justice Laskin as:[16]

> ... cutting through ... artificial barriers to relief that have resulted from over-extension of the doctrine of surrender in its relation to rent. Although it is correct to say that repudiation by the tenant gives the landlord at that time a choice between holding the tenant to the lease or terminating it, yet at the same time a right of action for damages then arises; and the election to insist on the lease or to refuse further performance (and thus bring it to an end) goes simply to the measure and range of damages. I see no logic in a conclusion that, by electing to terminate, the landlord has limited the damages that he may then claim to the same scale that would result if he had elected to keep the lease alive.

Mr. Justice Laskin goes on:[17]

> It is no longer sensible to pretend that a commercial lease, such as the one before this Court, is simply a conveyance and not also a contract. It is equally untenable to persist in denying resort to the full armoury of remedies ordinarily available to redress repudiation of convenants, merely because the convenants may be associated with an estate in land.

In his concluding statement, Mr. Justice Laskin overrules the *Goldhar* [18] case.

12. (1968) 1 D.L.R. (3d) 626.
13. (1967) 60 W.W.R. 193.
14. *Supra* n. 12.
15. (1906) 3 C.L.R. 704.
16. *Supra* n. 1 at 720-21.
17. *Id.* at 721.
18. *Supra* n. 6.

V. INTERPRETING *HIGHWAY PROPERTIES*

An analysis of the *Highway Properties* decision will be useful in determining what the Supreme Court judgment is saying, what the decision itself means, and what questions it leaves unanswered.

Laskin J. describes the issues included in the case as follows:[19]

> The substantial question emerging from the facts is the measure and range of damages which the landlord . . . may claim by reason of the repudiation by the tenant . . . of its lease of certain premises, and its consequent abandonment of those premises, where the landlord took possession with the contemporaneous assertion of its right to full damages according to the loss calculable over the unexpired term of the lease . . . . A common characterization of the problem in this appeal is whether it is to be resolved according to the law of property or according to the law of contracts; *but in my opinion, this is an over-simplification.* [Emphasis added.]

Mr. Justice Laskin's indication that the question is over-simplified has proven to the prophetic, in part at least, as a result of the failure of the Supreme Court of Canada to deal directly with the jurisprudential question of how to characterize a lease. This statement is true in the same sense that one does not classify an action as being in tort or contract on the basis of what damages are recoverable. Just as that difference, however, dictates the result, the decision as to which rules apply — contract or estate — determines which remedies the landlord can resort to. Regrettably, we are in a sense forced to work backwards. Based upon the conclusion that damages may be recovered in this situation, is the Court saying that normal contractual principles apply to leases?

Further, Laskin's belief that phrasing the issue as a dichotomy (to treat a lease as a contract or as a conveyance) is an oversimplification, is also true in the sense that the issue may be dealt with as a continuum, with positions between contract and conveyance. One possible method of analyzing the *Highway Properties* decision and the cases which have followed involves classifying the conceptions of the lease into the following categories:

1. A leasehold interest is a conveyance in the classical or traditional sense, totally distinct from contractual doctrines and principles;
2. A lease is a conveyance in the traditional sense, subject to the addition of *one* "contractual" remedy that permits the landlord to accept the tenant's repudiation of the lease and, upon giving the appropriate notice, to sue the tenant for damages suffered as a result;
3. A lease is a conveyance, but the landlord can employ the full arsenal of contractual remedies to enforce its terms, either:
   (a) in addition to the traditional remedies for enforcement of a lease, or
   (b) in substitution for the traditional remedies;
4. A lease is a conveyance in the sense that it operates to create an interest in land, but is subject to all principles of contractual law, insofar as those contractual principles do not conflict with the basic interest in land; or
5. A lease is purely a contract.

While keeping the above possible classifications in mind, any attempt to answer the question of whether a lease is to be governed by contractual or

19. *Supra* n. 1 at 711-12.

estate principles requires that it be analyzed by considering the more manageable issues specifically addressed by the decisions rendered subsequent to *Highway Properties*:

1. What remedies are available to a landlord where a tenant has defaulted under a lease?
2. Does the doctrine of surrender by operation of law still apply to leases?
3. What damages can be recovered by a landlord in situations where a tenant has repudiated the lease, and, in particular, is the landlord subject to a duty to mitigate his losses?

VI. LANDLORD'S REMEDIES

The language used by Mr. Justice Laskin in the *Highway Properties* decision is quite broad and would tend to indicate that the Supreme Court of Canada was prepared to give a landlord access to all remedies available in a breach of contract situation. The vast majority of the decisions that have followed upon *Highway Properties* have, however, tended to narrow or restrict the language and effect of the *Highway Properties* decision. In *Machula* v. *Tramer*,[20] *Fuda* v. *D'Angelo*,[21] *E. Parker Enterprises Ltd.* v. *Dud Hut Ltd.*,[22] *R. Millward Insurance Consultants Ltd.* v. *Nationwide Advertising Services Inc.*,[23] *Blight Enterprises Ltd.* v. *Great Eastern Furniture and Appliances (1979) Co. Ltd.*,[24] *Toronto Housing Co. Ltd.* v. *Postal Promotions Ltd.*,[25] *Hady Construction (1971) Ltd.* v. *Nelma Electronics Ltd.*[26] and *North Bay T.V. & Audio Ltd.* v. *Nova Electronics Ltd.*,[27] the Courts of Newfoundland, Nova Scotia, Ontario, Saskatchewan and Alberta have all concluded that the effect of the *Highway Properties* case is simply to recognize a fourth remedy available to the landlord in situations where the tenant has repudiated the lease.

Although the Nova Scotia Supreme Court in *E. Parker Enterprises Ltd.* v. *Dud Hut Ltd.*[28] acknowledges the existence of this fourth remedy, the judgment must be read with a certain degree of caution. In that case, the subtenant vacated the premises prior to the expiration of the term and the sublandlord commenced an action claiming *rent* for the balance of the term (approximately six months). While Mr. Justice Hallet interprets the *Highway Properties* case as adding a fourth alternative in situations where the tenant has repudiated the lease, he notes that in this particular case the sublandlord was not pursuing the fourth remedy. Instead, the sublandlord had elected to affirm the lease and sue for rent. He invokes a statement from Laskin's judgment indicating that there is certain merit in avoiding a multiplicity of actions to support his conclusion that the sublandlord can

20. [1972] 1 W.W.R. 550 (Sask. D.C.).
21. (1974) 43 D.L.R. (3d) 645 (Ont. H. Ct.).
22. (1979) 8 R.P.R. 322 (N.S. S.C.T.D.).
23. (1982) 48 A.R. 284 (Alta. Q.B.).
24. (1982) 39 Nfld. & P.E.I.R. and 111 A.P.R. 327 (Nfld. S.C.T.D.).
25. (1982) 140 D.L.R. (3d) 117 (Ont. C.A.).
26. Unreported, 3 February 1983, J.D. of York, 145626/81 (Ont. Co. Ct.).
27. (1983) 4 D.L.R. (4th) 88 (Ont. H. Ct.); *affd.* (1984) 12 D.L.R. (4th) 767 (Ont. C.A.).
28. *Supra* n. 22.

claim notwithstanding that the rent was not yet due. This, regrettably, confuses the matter. Rent should not be recoverable until it is due. Any claim for future rent must be in the nature of a claim for damages for prospective losses.

Additional confusion has been added by the decision of the Alberta Court of Queen's Bench in *United Management Ltd.* v. *Burnett*.[29] While Mr. Justice Moshansky states that "The defendants having repudiated the agreement to the lease, the plaintiff is entitled to damages"[30] which is consistent with the application of contract principles, he goes on to indicate that he could not "find that both parties evidenced their intention in the lease itself to recognize a right of action for prospective loss upon repudiation, as contemplated by the Supreme Court of Canada in *Highway Properties Ltd.* v. *Kelly, Douglas & Co. Ltd.*".[31] The conclusion that the lease must evidence an intention on the part of both parties to recognize the right of action for prospective loss in the event of repudiation, is not warranted by the decision in *Highway Properties*. It is also not consistent with contractual principles relating to repudiation, as they exist independent of the terms of the contract or lease.

Three decisions have tended to give a broader interpretation of the *Highway Properties* decision. In *1595 Properties Ltd.* v. *Sunshine Photo Finishing Ltd.*[32] Mr. Justice McEachern of the British Columbia Supreme Court states:[33]

> . . . the Supreme Court of Canada treated the lease as if it were an ordinary commercial contract and decided that even though the estate was determined and merged with the lessor's reversion, the contractual obligations owed by the tenant were still in force.

Similarly, the Newfoundland Court of Appeal in *Blue Chip Investments Inc.* v. *Hicks* [34] stated:[35]

> Thus, a landlord who elects to terminate a lease following repudiation by his tenant may avail of all the common law remedies available in contract law attendant upon a breach of contract. That of course would include prospective damages. Equally, the landlord may rely on any such rights set forth in a written contract.

In both of these decisions the landlord ultimately was not successful. In the *1595 Properties* case, the Court found that the tenant had not in fact repudiated the lease. In the *Blue Chip Investments* case the Court found the landlord was not entitled to claim damages as a result of its failure to give an appropriate notice as discussed below.

The New Brunswick Court of Queen's Bench in *Acadian Properties Ltd.* v. *R & T Foods Ltd.*[36] noted that at common law damages for breach of a lease were treated differently from a normal contract but that the situation had been changed by the *Highway Properties* case. This would tend to indicate that the New Brunswick Court of Queen's Bench was prepared to apply normal contractual principles to the situation.

29. Unreported, 2 August 1983, J.D. of Calgary, 8001-18825 (Alta. Q.B.).
30. *Id.* at 3.
31. *Id.* at 3.
32. [1983] 4 W.W.R. 377.
33. *Id.* at 379.
34. (1985) 18 D.L.R. (4th) 755.
35. *Id.* at 758.
36. (1984) 59 N.B.R. (2d) 285.

With respect to the question of a landlord's remedies *alone*, the track record of the cases is not encouraging. Even ignoring the cases that confuse the concepts, a clear majority have opted for the narrower interpretation of *Highway Properties*, concluding that it merely creates a fourth remedy for a landlord. These cases also tend to restrict the availability of the remedy based on certain conditions being satisfied, which should now be discussed.

A. PREREQUISITES TO THE AVAILABILITY OF THE FOURTH REMEDY

A secondary question to the consideration of what remedies are available to a landlord when a tenant repudiates a lease, is the question of what prerequisites must be satisfied before the landlord can avail itself of the right to damages for prospective losses. Some of these prerequisites have been alluded to above. The three possibilities can be identified in the *Highway Properties* decision itself, although the subsequent cases have not placed an equal emphasis on the three of them. Mr. Justice Laskin noted that the lease involved in the *Highway Properties* case contained what is known as a "continuous use covenant". That is, a covenant on the part of the tenant to continuously, actively and diligently carry on its business in the leased premises. The presence or absence of such a covenant has not been noted in any of the subsequent cases. While its absence should not affect the landlord's right to seek damages for prospective losses, it may very well affect what damages the landlord has suffered as a result of the tenant's repudiation of the lease and therefore would go to the question of *quantum*.

Of greater importance is the question of notice, which is referred to three times in the *Highway Properties* decision. The concept of a contemporaneous notice from the landlord to the tenant asserting the right to claim damages including prospective losses has been held to be a critical element to the success of such a claim in the decisions in *Machula* v. *Tramer*,[37] *Fuda* v. *D'Angelo*,[38] *R. Millward Insurance Consultants Ltd.* v. *Nation Wide Advertising Services Inc.*,[39] *Gander Shopping Centre Ltd.* v. *Powel*,[40] *Blight Enterprises Ltd.* v. *Great Eastern Furniture and Appliances (1979) Co. Ltd.*,[41] *Toronto Housing Co. Ltd.* v. *Postal Promotions Ltd.*,[42] *Hady Construction (1971) Ltd.* v. *Nelma Electronics Ltd.*,[43] *North Bay T.V. & Audio Ltd.* v. *Nova Electronics Ltd.*[44] and *Blue Chip Investments Inc.* v. *Hicks*.[45] The emphasis placed upon the matter of notice has tended to turn it into a very technical requirement that is in some sense a trap for the

37. *Supra* n. 20.
38. *Supra* n. 21.
39. *Supra* n. 23.
40. (1982) 39 Nfld. & P.E.I.R. and 111 A.P.R. 313 (Nfld. D.C.).
41. *Supra* n. 24.
42. *Supra* n. 25.
43. *Supra* n. 26.
44. *Supra* n. 27.
45. *Supra* n. 34.

unwary landlord. Based on the above decisions, the notice must indicate that damages are to be claimed on the basis of a present recovery of damages for losing the benefit of the lease for the unexpired term, including all unpaid and future rentals. The reason for the importance of the notice has, however, been either overlooked or ignored. Notice is also important under contract principles. Where one party has repudiated a contract, the innocent party must *elect* to either affirm the contract or to accept the repudiation. The breach can be accepted by commencing legal action or by giving notice. The repudiation is not accepted by inaction or acquiescence. The acceptance must be both complete and unequivocal.[46] The notice, therefore, is important for one of two possible reasons. If the effect of the *Highway Properties* decision is merely to create a fourth remedy, the notice is an essential element to establishing entitlement to damages for prospective losses. If, however, the contractual principles of repudiation and anticipatory breach are now to be applied to leases, the notice is simply one possible method by which the landlord can make its election to either affirm the lease or accept the tenant's repudiation of the lease.

One of the problems that has resulted from the failure to recognize the logical basis of the notice requirement has been a tendency on the part of the Courts to require that the notice be contemporaneous with the landlord's acceptance of repudiation of the lease. Whether as a result of poor choice of words or otherwise, this view of the notice requirement has tended to turn it into an excessively restrictive technical requirement. The Ontario Court of appeal may have recognized this in part in the *North Bay T. V.*[47] decision. That case holds that the notice need not be contemporaneous and can in fact be given by the commencement of proceedings.

Implicit in this entire discussion is the requirement that the tenant must have repudiated the lease. Laskin made it quite clear in the *Highway Properties* decision that the tenant had repudiated the lease. In fact, in that case, the tenant expressly repudiated the lease in its Statement of Defence to the landlord's original Statement of Claim.

The importance of the concepts of repudiation and anticipatory breach is greater than the cases have tended to recognize. Where a party has breached its contract, the innocent party has an election, and can choose: (1) to affirm the contract and insist upon performance by the defaulting party (seeking specific performance if necessary); (2) to terminate the contract (that is, to cancel the contract by way of the contractual rights of termination); or (3) to accept the repudiation of the contract and seek compensation for damages suffered. If the contract is terminated, the plaintiff can then claim only for matters occurring prior to date of termination.[48] In the event of repudiation, however, in the words of Mr. Justice Stevenson, ". . . once there is an accepted repudiation, all of the obligations in the contract come to an end and they are replaced, by operation of law, by an obligation to pay damages".[49] The risk of this latter

46. G.H. Treitel, *The Law of Contract* (4th ed. 1975) 581.

47. *Supra* n. 27.

48. *Celgar Limited* v. *Star Bulk Shipping Company* [1978] 3 W.W.R. 20 at 23.

49. *Luscombe* v. *Mashinter* (1978) 5 Alta. L.R. (2d) 164.

course of action is that if the plaintiff is unsuccessful in proving that the defendant's actions amounted to a repudiation, he will have disentitled himself any damages whatsoever. If the defendant has repudiated, the plaintiff will be entitled to claim damages for anticipatory breach of the entire contract. To understand how these principles apply in the context of a lease, it is useful to draw an analogy to an instalment contract. Consider a situation where a vendor delivers goods in instalments to the purchaser who is obliged to pay for each instalment upon delivery. Assume the purchaser has failed to pay for two instalments, refuses to accept a further instalment and advises the vendor that the purchaser will not accept or pay for any future deliveries. By his statements and actions the purchaser has repudiated the contract, and as indicated above, the vendor can: (1) insist upon performance; (2) terminate the contract and sue for payment for the last three instalments; or (3) accept the repudiation and sue for damages for losses over the balance of the contract. In the context of a lease, the landlord provides premises to the tenant in return for payment of rent on a periodic basis. Upon repudiation by the tenant, the landlord should have the same three options, namely: (1) to insist upon continued payment of rent; (2) to terminate the lease and sue for rental arrears; or (3) to accept the tenant's repudiation and seek damages for loss of benefit of the lease.

Unfortunately the question of whether the doctrines of repudiation and anticipatory breach apply to leases has been largely ignored by the subsequent cases. The importance of repudiation has been noted by the decisions in *Gander Shopping Centre*,[50] *Blight Enterprises*,[51] *Toronto Housing*,[52] *1595 Properties* [53] and *Marquis Holdings Ltd.* v. *Parsons*.[54]

VII. EFFECT OF THE *HIGHWAY PROPERTIES* DECISION ON THE DOCTRINE OF SURRENDER BY OPERATION OF LAW

One of the more difficult questions that the Courts have struggled with is the effect of the *Highway Properties* decision on the doctrine of surrender by operation of law. That is, what are the consequences of the landlord retaking possession of the premises after a tenant has repudiated the lease and abandoned the premises? Prior to *Highway Properties*, it was considered well settled that such an action on the part of the landlord would constitute an acceptance of the tenant's implied offer to surrender the premises. This would then result in a surrender of the lease by operation of law and put an end to the landlord's right to claim any rent or damages arising from the lease subsequent to the date of termination.

The Supreme Court of Canada in giving the landlord the option of either terminating the lease and suing for arrears or accepting the tenant's repudiation and seeking damages for prospective losses may render the landlord's actions in retaking possession of the premises equivocal. Based upon the options which *Highway Properties* makes available, the landlord's actions in retaking possession could be interpreted as either an

50. *Supra* n. 40.

51. *Supra* n. 24.

52. *Supra* n. 25.

53. *Supra* n. 32.

54. (1982) 37 Nfld. & P.E.I.R. and 104 A.P.R. 345 (Nfld. D.C.).

indication that the landlord is terminating the lease or that the landlord is retaking possession of the premises without prejudice to its right to seek further damages. Thus, the notice which must be given by the landlord to the tenant, stating the landlord's intention to seek such damages assumes greater importance.

There may, however, be a conflict that goes deeper than simply rendering the landlord's actions equivocal with respect to its election. If the prior law relating to the doctrine of surrender by operation of law remains alive, it is not possible for the landlord to claim damages after retaking possession unless a proper notice has been given. That is, once the landlord has retaken possession of the premises, in the absence of any notice respecting a claim for prospective losses, the landlord is presumed to have accepted the tenant's offer to surrender the lease. Once the lease has come to an end, the landlord has no claim for damages which arise after that date. There would appear to be a direct conflict between the estate principle of surrender which does not permit a claim for prospective losses, and the contractual principle of repudiation which does permit such a claim. One might have thought that this question was adequately dealt with when Laskin expressly stated that he would overrule the decision of the Ontario Court of Appeal in *Goldhar*, which was the leading decision expounding the doctrine of surrender by operation of law. In *Machula* v. *Tramer*,[55] however, the Saskatchewan District Court indicated that "*the other principles enunciated in the Goldhar case are not affected by the said decision of the Supreme Court.*"[56] Similarly, the Ontario Supreme Court in *Commercial Credit Corporation Ltd.* v. *Harry D. Shields Ltd.*[57] acknowledged that the *Goldhar* decision was overruled by the Supreme Court of Canada "but on other grounds".[58] The decisions in *Trustee of Estate of Royal Inns Canada Ltd.* v. *Bolus-Revelas-Bolus Ltd.*,[59] *R. Millward*,[60] *Blight Enterprises*,[61] *Bay Street Atria Ltd.* v. *Appeal Enterprises Ltd.*[62] and *Capital Land Developments Ltd.* v. *P.H. Restaurants Ltd.*[63] and *Re James Furniture Ltd.*[64] all assume that the doctrine of surrender by operation of law remains alive. As exemplified by the following quotation, the decision of Madame Justice McFadyen in *Nilsson* v. *Romaniuk* [65] implies that the doctrine of surrender by operation of law remains alive, and makes no reference to the *Highway Properties* case. Madame Justice McFadyen found that the

> . . . agreement was a lease with an option to purchase, which ended with repudiation by Gilfillan and acceptance of repudiation and the abandonment and surrender of the lease.

55. *Supra* n. 20.
56. *Id.* at 556.
57. (1980) 15 R.P.R. 136.
58. *Id.* at 146.
59. (1982) 136 D.L.R. (3d) 272 (Ont. C.A.).
60. *Supra* n. 23.
61. *Supra* n. 24.
62. Unreported, 6 October 1983, S.C. 10356/82 (Ont. S.C.).
63. Unreported, 13 November 1984, J.D. of Vancouver, CA 821341 (B.C.C.A.).
64. (1984) 53 C.B.R. (N.S.) 75 (B.C.S.C.).
65. (1984) 59 A.R. 39 (Alta. Q.B.).

> While the Romaniuks were entitled to recover rents due to date of surrender and damages to that date, they have no other right to claim damages.[66]

There are, however, a number of decisions which have recognized that the *Goldhar* decision has been overruled. These include *1595 Properties*,[67] *North Bay T. V.*,[68] *Acadian Properties* [69] and *Blue Chip Investments*.[70]

The possibility of the lease being expressly surrendered by course of conduct remains alive as recognized by the Saskatchewan Court of Queen's Bench in *Schmit* v. *Seed*.[71] If there has in fact been an express surrender, subsequent actions by the tenant cannot amount to repudiation and therefore the *Highway Properties* decision is inapplicable.

As pointed out above, regardless of whether the *Goldhar* case has been overruled or not, the question of notice being an indication of the landlord's election of remedies has assumed greater importance than it otherwise would in a contractual setting. The concern over whether the *Goldhar* case and the doctrine of surrender remain alive relates more to the timing of the notice. To date, only the Ontario Court of Appeal in *North Bay T. V.*[72] has indicated that the notice need not be contemporaneous with the landlord retaking possession of the premises. If the doctrine of surrender by operation of law has in fact been overruled, then the landlord's actions in retaking possession of the premises remain equivocal. Thus, the Ontario Court of Appeal's conclusion that the notice need not be contemporaneous would be correct and the landlord's election would not in fact be made until such notice was given. If, on the other hand, the doctrine remains alive, the effect of the *Highway Properties* decision has been further limited. The "fourth remedy" can only be invoked in situations where a notice is given prior to or at the time that the landlord retakes possession of the premises. Otherwise, the doctrine of surrender by operation of law remains paramount and the landlord's remedy is lost.

VIII. QUANTUM OF DAMAGES AND DUTY TO MITIGATE

Mr. Justice Laskin in the *Highway Properties* case indicated that there was no duty to mitigate under the existing law, but that mitigation might, in fact, be involved.[73] If a landlord is able to find a new tenant before the expiration date of the original lease, the rent payable by the new tenant would operate to mitigate the landlord's losses even though he had no duty to attempt to mitigate.

The Nova Scotia Supreme Court in *E. Parker Enterprises* [74] contains an *obiter* statement by Mr. Justice Hallett indicating that in his view the landlord should be required to mitigate. Mr. Justice Hallett did, however, recognize that the concept of mitigation may not apply to an action for rent, as was before him.

66. *Id.* at 51.
67. *Supra* n. 32.
68. *Supra* n. 27.
69. *Supra* n. 36.
70. *Supra* n. 34.
71. (1982) 20 Sask. R. 224.
72. *Supra* n. 27.
73. *Supra* n. 1 at 718.
74. *Supra* n. 28.

Mr. Justice Lomas in *Krenzel* v. *Interprovincial Security Patrol (Red Deer) Ltd.*,[75] while not commenting on whether the landlord has a duty to mitigate, does deduct the rent received by the landlord on reletting the premises from the damage claim, resulting in no award of damages to the landlord. That is, the money received was regarded as mitigation in fact, regardless of whether or not there was a duty to mitigate.

The decision of Master Funduk in *Athan Holdings Ltd.* v. *Merchant Holdings Ltd.*[76] and of the B.C. Supreme Court in *1595 Properties*[77] confirm that an action of this nature is a claim for damages which must be assessed. Default judgment cannot be entered, and the Master's jurisdiction does not extend to assessing such damages. *Obiter dicta* in the *Gander*[78] and *Marquis*[79] cases and in *Birkdale Realty* v. *McLean*[80] indicated that the landlord is under a duty to mitigate in situations where he is pursuing a claim for prospective losses. In the *Gander* case, Judge Ender of the Newfoundland District Court stated that the landlord did not satisfy the court that it took any reasonable steps in mitigation of its claim. He also noted that in setting damages, to award damages equal to rent over the balance of the term required the assumption firstly of the inability of the landlord to re-let the premises and secondly the assumption that there would be no upturn in the economy. Judge Ender indicates a need for expert evidence with regard to those two matters.

The Blight Enterprises decision is one of the better discussions of the *quantum* or calculation of damages in these cases. Mr. Justice Steele of the Newfoundland Supreme Court states:[81]

> Evidence respecting damages was scanty, as Watton assumed that Blight was entitled to all unpaid rent for the unexpired term of the lease. Unfortunately for Blight the matter is not quite that simple. The question of determining or assessing damages is not just the mathematical calculation of the unpaid rent for the balance of the unexpired term of the lease. This is merely the starting point.
>
> Under the common law a landlord is not under a duty to mitigate damages but presumably he may. Mitigation is involved, however, where there is a reletting on the tenant's account. In the present case the landlord did not enter into possession upon notice to the tenant that it intended to relet on Great Eastern's account. (Third option). If a proper deduction from unpaid rentals is the actual rental value for the remaining term of the lease, I assume that in the absence of evidence of a reletting a legitimate deduction would be the estimated or projected rentals that might reasonably be expected to be received over the unexpired term of the lease. My difficulty is, of course, the complete lack of evidence on the point.
>
> I appreciate that leasing the premises, which has a restricted use, may not now be an easy task. The premises were vacant at the date of the trial in the middle of June 1982 with no prospective tenant of any certainty. The premises may now be leased, but I do not know that.
>
> I must also keep in mind that for the premises to be again leased Blight may very well be put to additional expense. The fact is that there are any number of factors that could and probably would affect the assessment of damages. To this extent my assessment of damages must be arbitrary.

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75. (1982) 38 A.R. 153 (Alta. Q.B.).
76. (1982) 40 A.R. 199 (Alta. Q.B.).
77. *Supra* n. 32.
78. *Supra* n. 40.
79. *Supra* n. 54.
80. (1984) 64 N.S.R. (2d) 409 (N.S. Co. Ct.).
81. *Supra* n. 24 at 338. See also *Fuda* v. *D'Angelo*, *supra* n. 21 and *Jerol Investments Ltd.* v. *Deaco Holdings Ltd.* (1983) 28 Sask. R. 137 (Sask. Q.B.).

This decision points to the need for evidence respecting the damages suffered, the efforts made to mitigate, the likelihood of reletting the premises, the expense of reletting the premises, and the anticipated rental to be received during the balance of the term of the repudiated lease.

The Ontario Court of Appeal in *Toronto Housing* [82] declined to express an opinion on whether or not there is a duty on the part of the landlord to mitigate. The Court found that the landlord had in fact mitigated. In this case the tenant had vacated the premises and they remained vacant for a period of nine months. The landlord found a new tenant to whom he rented the premises at a substantially increased rent. The landlord then commenced an action for the rental arrears accruing during the nine months that the premises were vacant. The tenant counterclaimed seeking the excess rent. Both claims were dismissed, the landlord's on the basis that it had in fact mitigated, regardless of whether there was a duty to mitigate. The increased rent operated to mitigate the loss suffered by the landlord during the nine months that the premises were vacant and for which the tenant failed to pay rent. It is submitted that the Court of Appeal did not draw a proper analogy to the contract situation in considering this case. In a contract for the delivery of goods in instalments, if the purchaser were to fail to pay for nine instalments that had been delivered, the vendor could exercise a contractual right to terminate the agreement. The vendor would then be in a position to sue for the nine instalments regardless of the amount for which he might sell the remainder of the goods. Those nine instalments would be a debt due, similarly the arrears of rent in this case would be a debt due. The principle of mitigation should apply only to damages and prospective loss of rent, not to debts and rental arrears.

The subsequent decision of the Ontario County Court in *Hady Construction* [83] is inconsistent with the *Toronto Housing* case. The Court there recognized that where the landlord failed to give the appropriate notice, and was therefore precluded from seeking damages for prospective losses, it was still entitled to judgment for arrears of rent owing up to the date the lease was terminated. The Court concluded that any rents received by the landlord after the date of termination would not operate in mitigation of the landlord's claim for arrears of rent, thereby recognizing the difference between arrears and prospective losses.

The decision of the Nova Scotia Supreme Court Trial Division in *Marex Properties Ltd.* v. *SMP Organics Ltd.*[84] and of Mr. Justice Moshansky in the *United Management* [85] case are sources of additional concern for landlords. Both of these cases indicate that the landlord is under a duty to mitigate its losses. These cases go further in indicating that the landlord in its efforts to mitigate its losses may be required to seek tenants whose business would not otherwise be permitted in the leased premises, notwithstanding that the landlord may find that business to be disruptive to the tenant mix in a shopping centre or the tenant to be otherwise undesirable. In the *Marex* decision, the Court deducted two months rent

82. *Supra* n. 25.

83. *Supra* n. 26.

84. Unreported, 14 June 1983, J.D. of Halifax, S.H. No. 38877 (N.S. S.C.).

85. *Supra* n. 29.

from the damage award representing what could have been received by the landlord if they had rented the premises to a video store as opposed to another drugstore. In the *United Management* case, Mr. Justice Moshansky was critical of the landlord both for restricting its search for replacement tenants to restaurants and also for seeking rental amounts greater than that payable by the repudiating tenant.

The decision of Mr. Justice Meldrum of the New Brunswick Court of Queen's Bench, Trial Division in *Acadian Properties* [86] discusses what heads of damages the landlord may seek in situations where the tenant has repudiated the lease. In this case the landlord recovered taxes, rent while the premises were vacant, the rent shortfall (that is the difference in rent payable by the repudiating tenant and the new tenant), the cost of repairs, cleaning and electricity while the premises were vacant and the real estate commission payable to the agent for locating a replacement tenant.

Canadian jurisprudence in this area now appears to impose a duty on the part of the landlord to mitigate its losses in the event of repudiation by the tenant. In order to claim the maximum *quantum* of damages from the tenant, the landlord must provide detailed evidence of all of its damages. In particular, it is necessary to provide evidence relating to the discounted value of future rent, the effect of inflation on operating costs or additional rent, the likelihood of re-renting the premises and the rental value of the premises at the time the tenant repudiated the lease. Some or all of these may require expert evidence of an actuary or real estate agent. It is also important to remember that in exercising reasonable efforts to mitigate its losses, the landlord may be required to alter the tenant mix and to rent the premises to tenants that might not otherwise be considered desirable.

IX. RECONCILIATION

Having now considered the specific questions of the landlord's remedies, the doctrine of surrender by operation of law and the duty to mitigate, we can return to the categorizations of the lease outlined earlier in this paper.[87] The categories identified are, briefly:

1. a lease is a conveyance;
2. a lease is a conveyance subject to the addition of one new remedy;
3. a lease is a conveyance but the landlord may resort to all contractual remedies either:
   (a) in addition to the traditional remedies for enforcing a lease; or
   (b) in substitution for the traditional remedies;
4. a lease is a conveyance but is subject to all the principles of contractual law insofar as they do not conflict with the basic interest in land; or
5. a lease is a contract.

How should the cases be categorized? The *Goldhar*,[88] *Belboys* [89] and *South End* [90] cases, together with the British Columbia Court of Appeal

86. *Supra* n. 36.
87. *Supra* p. 481.
88. *Supra* n. 6.
89. *Supra* n. 10.
90. *Supra* n. 11.

decision in *Highway Properties* [91] are clearly in the first category. This is the starting point. Only one of the subsequent decisions, that is, *Nilsson* v. *Romaniuk*,[92] belongs in this category, as it makes no reference to the Supreme Court of Canada judgment in *Highway Properties*, relies upon the direct doctrine of surrender by operation of law and prohibits the landlords from claiming any damages subsequent to the "termination" of the lease.

Justice Laskin's judgment in *Highway Properties* makes the jump to the fourth category, if regard is had to the breadth of the statements contained in the decision. Many of the cases that have followed it, however, have not been as bold or as quick to move so far. *Machula*,[93] *Fuda*,[94] the trial decision in *Commercial Credit*,[95] *Trustee of Royal Inns*,[96] *R. Millward*,[97] *Hady*,[98] *Bay Street Atria* [99] and *Capital Land* [100] all seem to move only to category two. These decisions tend to indicate that the effect of the *Highway Properties* judgment is only to create a new remedy to which the landlord can resort in certain, very limited situations, and only upon the landlord having given a technically correct notice at the proper time.

Classifying the *E. Parker Enterprises* [101] case is difficult. As the Court in that case applied the principle of mitigation of damages to what appeared to be an action for future rent, it may take a position as high as 3(a). Or, it may, as indicated above, belong in the second category on the basis that the case confuses the concepts rather than applying them.

The largest number of the subsequent decisions tend to fall within category three. That is, they determine that a lease is still primarily a conveyance but give access to the full armoury of contractual remedies. It is, however, difficult in many of the decisions to determine whether these new contractual remedies are in addition to or substitution for the more traditional estate remedies. The cases that can be considered as falling within category three are *Blight*,[102] *North Bay T.V.*,[103] *Blue Chip Investments*,[104] *Gander*,[105] *Marquis*,[106] *Athan*,[107] *Birkdale*,[108] *Marex*,[109] *Toronto*

91. *Supra* n. 12.
92. *Supra* n. 65.
93. *Supra* n. 20.
94. *Supra* n. 21.
95. *Supra* n. 57.
96. *Supra* n. 59.
97. *Supra* n. 23.
98. *Supra* n. 26.
99. *Supra* n. 62.
100. *Supra* n. 63.
101. *Supra* n. 28.
102. *Supra* n. 24.
103. *Supra* n. 27.
104. *Supra* n. 34.
105. *Supra* n. 40.
106. *Supra* n. 54.
107. *Supra* n. 76.
108. *Supra* n. 80.
109. *Supra* n. 84.

Housing,[110] *Krenzel*,[111] *Acadian* [112] and the decision of the Ontario High Court in *Peppe's, The Pizza Factory Ltd.* v. *Stacey*.[113] The question before the Ontario High Court in this last case was whether a leasehold interest is a sufficient interest in land to justify the granting and registration of a certificate of *lis pendens*. Mr. Justice Dupont referred to the *Highway Properties* case and found that the Supreme Court of Canada had:[114]

> . . . held that it was unfair to restrict the landlord to the limited remedies available to redress repudiation of covenants associated with an estate in land. The Court concluded that a commercial lease was not only a conveyance but also a contract. However, in adding the contractual dimension to a lease they did not eliminate the estate in land.

Three of these decisions can quite properly be categorized as leval 3(b), that is, *Toronto Housing*,[115] *Krenzel* [116] and *Acadian*.[117] In fact, if regard is had to the statements in the *Krenzel* case concerning fundamental breach, there can be seen an indication of movement towards the fourth category. The *North Bay* [118] decision may also properly belong in category 3(b). The decision of the Ontario Court of Appeal indicating that the notice need not be contemporaneous is consistent with the application of the doctrine of repudiation to leases. As indicated above, it appears to be the only decision to date which has taken such a bold stand.

Very few of the Canadian cases can be seen as joining the Supreme Court of Canada in the fourth category. Arguably, the *United Management* [119] decision belongs at this level, on the basis of that case finding quite clearly a duty to mitigate on the part of the landlord and in fact imposing a fairly heavy onus on the landlord in respect of the steps which it must take to discharge that duty. There is, however, the difficulty of that case requiring a provision in the lease evidencing the intention of the parties to recognize the right of action for prospective losses. To that extent, the case is not reliable. *1595 Properties* [120] should also be considered in category four, together with another decision of the British Columbia Supreme court, *Cedar Valley Investments Inc.* v. *City of Port Moody*.[121] The *Cedar Valley* decision arose out of an application by the landlord to strike out a statement of claim. The tenant had brought an action against the landlord seeking damages for the landlord unreasonably withholding its consent to an assignment of the lease. After referring to the *Highway Properties* decision, Mr. Justice Oppal indicates that the "rules governing leases of real property ought to be reconsidered because they no longer meet the reasonable expectations of commercial enterprises."[122]

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110. *Supra* n. 25.
111. *Supra* n. 75.
112. *Supra* n. 36.
113. (1979) 27 O.R. (2d) 41.
114. *Id.* at 45-46.
115. *Supra* n. 25.
116. *Supra* n. 75.
117. *Supra* n. 36.
118. *Supra* n. 27.
119. *Supra* n. 29.
120. *Supra* n. 32.
121. (1981) 22 R.P.R. 80.
122. *Id.* at 83-84.

It is not, however, as lonely at category four as it might seem. The Australian cases[123] which were cited by Mr. Justice Laskin in the *Highway Properties* decision probably fall within category four. Similarly, the decisions of the House of Lord's in *Cricklewood Property and Investment Trust, Ltd.* v. *Leighton's Investment Trust Ltd.*[124] and *National Carriers Ltd.* v. *Panalpina (Northern) Ltd.*[125] both should be placed at the lofty height of category four. Further the recent decisions of the American Courts[126] indicate that they have ascended beyond all these to the final point of finding a lease to be a pure contract.

It is submitted that the fourth category should be the goal for our Courts. It is perhaps more sensible to acknowledge that a lease is a contract as well as a conveyance, not only with regard to the remedies available to redress a breach, but also as concerns the applicability of such doctrines as frustration. There may be, however, some unforeseen dangers in taking the final step of holding a lease to be only a contract, particularly in torrens jurisdictions such as Alberta. Before any such final assault is made, it would be wise to consider all of the implications of that principle.

Section 21 of the Landlord and Tenant Act[127] has essentially codified the *Highway Properties* decision with repsect to residential tenancies in Alberta. (The section does not apply to commercial leases.) This legislation reflects the broader interpretation of Laskin's judgment, as it does not contain any special notice requirements and expressly imposes a duty to mitigate on the landlord. There is, therefore, little doubt that we have attained the fourth category in Alberta so far as residential leases are concerned.

The concept of a lease being subject to all contractual doctrines, to the extent that they are not inconsistent with the basic interest in land created by the lease, could eliminate many of the uncertainties that presently surround this area. Clarification of the notice as being one method by which the landlord can elect its remedies and a clear announcement of the death of the doctrine of surrender by operation of law would remove the pitfalls that have become traps for the unwary landlord. There is no justification for the creation of overly restrictive technical prerequisites to a remedy of this sort. Further clarification of the landlord's duty to mitigate, together with the recognition of the distinction between arrears of rent and damages for prospective losses would be of great assistance in permitting the landlord to organize its affairs and make reasonable, logical decisions as to which course of action it should follow in situations where a tenant has repudiated its lease. While it would appear that we have not as

123. *Buchanan* v. *Byrnes*, *supra* n. 15; *Hughes* v. *N.L.S. Pty. Ltd.* [1966] W.A.R. 100 (W. Austl. S.C.).

124. [1945] A.C. 221.

125. [1981] 1 All E.R. 161.

126. See *Grueninger Travel Service of Fort Wayne, Indiana, Inc.* v. *Lake County Trust Co.* 413 N.E. 2d 1034 (Ind. C.A. 1980) and *United States National Bank of Oregon* v. *Homeland, Inc.* 631 P. 2d 761 (Or. S.C. 1981).

127. R.S.A. 1980, c. L-6. This section has been considered by Master Quinn in *Rancho Realty (Edmonton) Ltd.* v. *Acheson*, unreported, 10 August 1982, J.D. of Edmonton, 8203-08770 (Alta. Q.B.). See also s. 25 of the Mobile Home Sites Tenancies Act, S.A. 1982, c. M-18.5.

yet clearly reached category four and that many Courts continue to slide backwards in their attempt to reach the summit, the writer believes that we can properly view the present circumstances as being a period of transition. Hopefully all of the difficulties will soon be surmounted and we will all be able to share in a clear understanding of the principles that are properly applicable to a lease.