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Tenant Utility Arrears – Important Law for Commercial Landlords

Commercial landlords should be aware of the law making them potentially liable for utility arrears incurred by their tenants. This article sets out the preliminary points for landlords' consideration.

First, the legal framework for this obligation is found in the *Municipal Act, 2001* which contains provisions – formerly embodied in the Ontario *Public Utilities Act* – allowing municipalities to add to the tax bill of a property any utility arrears incurred by tenants. These charges can be added at the local board's request, and (in keeping with Ontario Regulation 581/06) can cover fees and charges relating to sewage/waste management, or the supply of water or steam. Under the Act, these charges have priority lien status; the overall result is that since they are added to the rental property's tax roll, the landlord/property owner can become liable for them.

This legislative provision is significant to landlords, as it essentially overrides previous court decisions holding it unreasonable for a landlord to be held liable – essentially as a guarantor – for utility charges that the landlord did not personally incur. It affects particularly those property owners with commercial, office and industrial tenancies, because in Ontario the vast majority of such leases are drafted to allocate all risks relating to occupancy costs onto the tenants, including those relating to utility consumption. Therefore, commercial landlords will need to consider how to respond to these potential obligations in connection with both existing and future tenancies. Landlords should consider taking the following steps:

- Contact the relevant municipality to determine existing municipal policy in connection with tenant utility arrears.
- Obtain confirmation in writing, including written indication as to the date on which the municipal policy will change. (This will allow landlords to try to prevent the municipality from adding arrears to the tax bill in the event that the municipality failed to provide that written notice).
- Review existing leases to determine whether their terms allow for: 1) information to be obtained relating to the status of tenant utilities; 2) the interruption, without liability, of the supply of utilities to a tenant; and 3) the recovery of any amounts paid to a utility by a landlord in cases where the tenant has failed to pay for its own consumption.

The review of existing tenancies should also consider the risk relating to *prior* utilities consumption, by assessing the strength of any general or specific lease term allowing a landlord to recover unpaid utility arrears from tenants.

Landlords should develop a strategy to get voluntary compliance from tenants with high-risk tenancies and inadequate leases. They may also want to protect themselves through adjustments to existing leases: for example, where tenants require the consent (e.g. for the assignment or subletting of a lease, changes in use, etc.), landlords may want to impose a condition requiring the lease to be amended to address liability for tenant utility arrears, before that consent will be given. This will require landlords to consider their existing legal rights and obligations under both the lease, and under legislation such as the *Commercial Tenancies Act*.

Landlord Stripped of Property that Tenants Used as Grow House

A British Columbia landlord lost title to two of his three rental properties, because his tenants had used them as marijuana grow houses. This case may have relevance in Ontario as well, since this province has legislation similar to B.C.'s *Civil Forfeiture Act*, which permits the seizure of property that comprises either "proceeds of an unlawful activity" or "an instrument of unlawful activity".

In the B.C. case, the landlord owned three homes in Vancouver. He struck a deal with a friend: she would take over the job of finding him tenants, and she could keep anything over $800 in rent per month per unit. The landlord did not screen tenants, nor did he inspect the premises during the terms of their leases. In fact – and despite being an experienced landlord and investor – he did not even know the tenants' names and never spoke or communicated with them. All tenants paid in cash, and the rents were never reported on the landlord's income tax returns.

On this basis, the three homes were rented to tenants chosen by the landlord's friend. However, the police were prompted to search the homes, and found marijuana grow operations consisting of more than 2,000 plants. The tenants were arrested but the landlord was not criminally charged; in fact it later came to light that several other houses owned by the landlord (and later demolished or sold) were also being used as grow houses. The landlord was never charged with any crime relating to those operations, either.

In connection with these three properties, the B.C. Director of Civil Forfeiture applied to the court to have the landlord's rental receipts declared "proceeds of an unlawful activity". It also wanted to have the grow houses designated as "instruments of an unlawful activity". In his own defence, the landlord relied on a provision in the B.C. legislation stipulating that that an owner would escape liability if he or she did not "directly or indirectly engage" in the unlawful activity. He claimed that he had no actual knowledge of the grow houses, but admitted that such actual knowledge could have been readily available had he exercised some diligence. The friend whose role was to find tenants gave similar testimony.

The court agreed with the Director of Civil Forfeiture. It assessed the landlord's evidence as lacking credibility, and was not swayed by his explanation for using the friend to find tenants when she had no prior experience in doing so. Instead, it found that the landlord had been "wilfully blind": by using the friend as an intermediary, he could remain ignorant of how the properties were being used and could escape legal liability. For other rental properties that the

landlord also owned, he had taken active steps to know the tenants' names, and had collected the majority of the rent in person. The court found that the landlord's lack of reporting the rental income on his tax returns was also telling.

In the end, the court declared the full $24,000 in rent for the three properties to be the "proceeds of unlawful activity", and ordered that amount forfeited. Also, the landlord had $360,000 in equity in three of the houses he owned, and the court ordered that the landlord was to forfeit two of the three of them.

In Ontario – where the provincial *Civil Remedies Act* has similar provisions – this case serves as an important warning to landlords.

Landlords are strongly encouraged to screen potential tenants, and to actually check any references that are provided. Also, landlords should conduct regular visits to the property or hire a property manager.

See *British Columbia (Director of Civil Forfeiture) v. Rai*, 2011 (BCSC).

Creditor's Action to Enforce Judgment Severed Joint Tenancy

An Ontario Court decision illustrates how a creditor's steps to enforce judgment against a debtor can effectively sever the debtor's joint tenancy with another party.

In 1992, John and Agnes bought a condominium unit as joint tenants. When they defaulted on their mortgage with Royal & SunAlliance Insurance Company ("Royal"), Royal obtained a default judgment against John for more than $730,000, and then obtained a writ of seizure and sale for the condo. John paid about $44,000 toward satisfying the debt in 1999, but paid nothing further. Royal then instituted sale proceedings and informed John and Agnes by letter in 2001. The property was advertised for sale as required, including an advertisement in a local paper. However, the condo unit failed to sell.

Meanwhile, in 2006 Agnes executed a will, leaving John all her property except for her joint share of the condo, which she left to her son Michael. She died in November 2008, and when Royal learned of the fact, it sought a court order deleting Agnes' name as joint owner of the condo, and amending Registry records to show John as the sole surviving joint tenant.

The son Michael resisted, however, claiming he was the successor as tenant-in-common under Agnes' will. Specifically, he claimed the original joint tenancy was severed when Royal tried to collect against John. Royal disagreed, claiming instead that John became the sole owner when Agnes died. Alternatively, it claimed that Agnes' interest as tenant-in-common passed to her husband, rather than to her son.

The Ontario Superior Court dismissed Royal's application, agreeing that the steps it took to enforce the judgment against John legally severed the joint tenancy. By itself, filing a writ of execution did not result in severance, but the act of advertising the sale was sufficient to commence execution. Indeed, Royal's steps in this case had gone even further, and effectively severed the joint tenancy and converted it to a tenancy-in-common. Agnes' will was evidence of her intent to bequeath her half-interest in the condo to her son Michael. This left Royal with only the right to effect its execution against John's 50 per cent undivided interest in it. See *Royal & SunAlliance Insurance Company v. Muir and Muir*, 2011 (ONSC).

Collateral Mortgage Defaults

A recent decision highlights the importance of clarifying rights and obligations in connection with collateral mortgages, especially involving family members.

In 1999, Maria appointed her three children under a power of attorney for property. One of them, a daughter named Renata, arranged for Maria to obtain a new first mortgage with MCAP as mortgagee ("Maria's Mortgage"). Renata guaranteed Maria's Mortgage, and also made payments under it. At the same time, she also refinanced the home she shared with her husband, under a separate mortgage arrangement. Its terms stipulated that default under one mortgage constituted default under the other.

From that point, a series of irregularities prompted confusion, and resulted in litigation between the parties. Specifically, Renata and her husband sold their home and had the mortgage discharged. Surprisingly, she received the balance of the sale proceeds from MCAP by cheque, contrary to her assumption that the remaining proceeds would be applied against Maria's Mortgage balance. Indeed, Renata contacted MCAP to advise them of the error, but its representative told her that she and her husband could keep the funds and continue to make the monthly payments on Maria's Mortgage.

However, Maria's lawyer later caught the error and contacted MCAP to inquire as to why Maria's Mortgage had not been discharged (along with Renata's) when Renata's home was sold. MCAP agreed to the discharge in of July 2008; nonetheless, Renata continued to make monthly payments on it. A year later, in August 2009, MCAP advised Renata that Maria's Mortgage had been discharged in error and that there was still an outstanding balance due.

Renata filed for bankruptcy a month later. MCAP sued both Maria and Renata, and in 2010 moved for summary judgment. MCAP claimed that there was default under Maria's Mortgage, and that Maria as mortgagor was liable for the full amount outstanding. It claimed that Maria benefited from the advance by MCAP toward Maria's Mortgage, since she had paid off another, different $50,000 mortgage to another bank by using those funds.

In contrast, Maria argued that Maria's Mortgage was collateral to the one held by Renata, that she entered into it merely to help her daughter, and that she was merely an "accommodating surety". In fact, having discharged it in 2008, MCAP clearly viewed her mortgage as a collateral one to Renata's. As such, the discharge of Renata's mortgage should have discharged Maria's Mortgage simultaneously.

The court considered these arguments, agreeing that the two mortgages were collateral to each other, and that default under one constituted default under the other. However, neither mortgage provided that *payment or discharge* of one mortgage constituted *payment or discharge* of the other. Therefore, when Renata's mortgage debt was paid off in full, this did not serve to discharge Maria's Mortgage. That mortgage clearly listed Maria as mortgagor, and its terms stipulated that the mortgage guarantor agreed to be liable along with the borrower as principal debtor, not as a surety. Therefore, even if Maria was a guarantor rather than mortgagor, the legal effect was the same.

The court also disagreed that Maria was an "accommodating surety". She had benefited from the funds advanced by MCAP, and there were no terms in the documents to suggest she was a collateral borrower. In addition, there was no contractual obligation on MCAP to apply the proceeds of the sale of Renata's home to the outstanding liability under Maria's Mortgage. There was also nothing unconscionable about MCAP accepting monthly mortgage payments from Renata and her husband even after Maria's Mortgage was discharged. These payments ultimately benefited Maria, by reducing the principal amount outstanding. The mortgage was repeatedly renewed by Renata, who had the authority to do so under power of attorney she had been granted by Maria. Judgment in favour of MCAP was ordered. See *MCAP Service Corporation v. Bak and Pasche*, 2011 (ONSC).