Do I have an Enforceable Contract?: The Importance of Entering into a Third Party Agreement in a Sublease

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A recent decision out of the Ontario Superior Court is a firm reminder of the importance for a landlord to enter into an agreement directly with the new third party whenever there is a sublease in a commercial building. Without this agreement in place, there is no contractual privity between the landlord and the new party, and thus, no direct right of recovery where the third party is in breach of the terms of the contract.

In *2129152 Ontario Inc v Pliamm et al*, 2017 ONSC 4451 ("*Pliamm*"), Justice Gordon re-examined the rights and obligations between commercial landlords, sublandlords, and subtenants. The facts of this case are simple. The Landlord and Sublandlord entered into head leases which allowed commercial space in a Toronto strip mall to be used for medical and related services. The head leases contained the following provision, commonly referred to as a "continuous occupancy clause":

For the whole of the Term [sic] Tenant shall continuously and actively conduct its business in at least a portion of the Premises for the purpose set out in Section 1.1(b) (and only for such purpose) in a first class and reputable manner.

The Sublandlord then subsequently entered into subleases with the Subtenants. Each sublease contained the following provision:

The Subtenant covenants with the Sublandlord as follows:

...to observe and perform all covenants, agreements and obligations of the Sublandlord to be observed and performed under the terms of the Lease, as they may apply to the Sublease Premises only, as if the Subtenant were the Tenant under the Lease (save and except as provided in section 20 of the Sublease), and as if the Sublandlord were the Landlord under the Lease, and such covenants, agreements and obligations are incorporated herein by reference. The Subtenant acknowledges that it has received a copy of the Lease.

After signing the subleases, the Subtenants began operating their medical businesses in the strip mall. Prior to the expiry of the lease term, however, the subtenants suddenly

moved their businesses to a different location. This left the premises largely vacant and uninviting to other potential tenants of the building. As a result, the Landlord claimed that the Subtenants were in default of the continuous occupancy clause, and because of this, the Landlord argued that the Landlord had the legal right to enforce the covenant. Consequently, the main question for Justice Gordon was: Did the Landlord have a right to make a claim directly against the Subtenant? The Court decided that the Landlord did not enjoy such right.

In Justice Gordon's view, the word "direct" required that a formal agreement or promise be made between the specific parties relying upon it. In this case, the Landlord was not a party to the subleases and had no other direct contractual dealing with the Subtenants. Given that the very specific wording of each lease was that, "The Subtenant covenants with the Sublandlord as follows: ...", Justice Gordon concluded that the Landlord cannot be said to have had a direct covenant from the Subtenants.

This case is a reminder of the importance for a landlord to enter into a third party agreement whenever there is a sublease in a commercial building. The Landlord in *Pliamm* could have established privity with the Subtenants by simply entering a direct agreement (typically as part of the Landlord's consent to the sublease) with a clause similar to the following:

The Subtenant hereby covenants and agrees with the Landlord that:

1. It will at all times from the Effective Date during the term of the Sublease, observe and perform all of the terms, covenants and conditions contained in the Lease on the part of the Tenant therein to be observed and performed as and when the same are required to be observed and performed as provided by the Lease as they pertain to the subleased premises, including, without limitation, the provisions of the Lease relating to the permitted use of the Premises.
2. It will indemnify and save harmless the Landlord from all actions, suits, costs, losses, charges, demands and expenses for and in respect of any such non-observance or non-performance from and after the Effective Date.

In the absence of an agreement such as the one above, however, the Landlord in *Pliamm* had no recourse against the Subtenants directly. Simple contract rules cannot be forgotten — *If there is no privity between the parties, then there is no right of recourse under contract law.*

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