

2009 CarswellOnt 5391
Ontario Superior Court of Justice (Divisional Court)

Royal Bank v. MacPherson

2009 CarswellOnt 5391, [2009] O.J. No. 3806, 181 A.C.W.S. (3d) 358, 311 D.L.R. (4th) 361, 86 R.P.R. (4th) 253

Royal Bank of Canada, Appellant and John MacPherson, Respondent

Janet Wilson, Lederman, K. Swinton JJ.

Heard: June 3, 2009

Judgment: September 8, 2009

Docket: Toronto 57/08

Counsel: Amanda Jackson, for Appellant

No one for Respondent

Subject: Property; Corporate and Commercial

Headnote

Real property --- Landlord and tenant — Residential tenancies — Leases — Covenants

Tenant entered into lease with owner of home — Tenant prepaid rent for entire year and received discount for doing so — Prepayment of rent was term of lease — Owner defaulted on mortgage — Bank became mortgagee in possession — Bank brought unsuccessful application for eviction, arrears of rent and termination of tenancy for non-payment of rent — Bank appealed decision — Appeal dismissed — Bank stepped into shoes of landlord and had no right to demand further rent from tenant who had pre-paid rent — Board did not err in finding that pre-payment of rent was covenant that ran with land — Bank was bound by covenant and could not seek order for rent already paid and was not entitled to eviction of tenant.

Real property --- Landlord and tenant — Residential tenancies — Rent — Obligation to pay — General principles

Tenant entered into lease with owner of home — Tenant prepaid rent for entire year and received discount for doing so — Prepayment of rent was term of lease — Owner defaulted on mortgage — Bank became mortgagee in possession — Bank brought unsuccessful application for eviction, arrears of rent and termination of tenancy for non-payment of rent — Bank appealed decision — Appeal dismissed — Bank stepped into shoes of landlord and had no right to demand further rent from tenant who had pre-paid rent — Board did not err in applying ss. 105 and 106 of Residential Tenancies Act, 2006 — Pre-payment of rent by tenant was not illegal — Bank could not seek order for rent already paid and was not entitled to eviction of tenant.

Real property --- Mortgages — Possession and ejection — Rights and duties of mortgagee in possession — Miscellaneous
Tenant entered into lease with owner of home — Tenant prepaid rent for entire year and received discount for doing so — Prepayment of rent was term of lease — Owner defaulted on mortgage — Bank became mortgagee in possession — Bank brought unsuccessful application for eviction, arrears of rent and termination of tenancy for non-payment of rent — Bank appealed decision — Appeal dismissed — Bank stepped into shoes of landlord and had no right to demand further rent from tenant who had pre-paid rent — Board did not err in applying ss. 105 and 106 of Residential Tenancies Act, 2006 — Board did not err in finding that pre-payment of rent was covenant that ran with land — Bank could not seek order for rent already paid and was not entitled to eviction of tenant.

APPEAL by bank of order dismissing application for eviction, arrears of rent and termination of tenancy for non-payment of rent.

Janet Wilson J.:

The appeal

1 The Royal Bank of Canada (the Bank) appeals from the order of the Landlord and Tenant Board dated January 3, 2008 (the Board).

2 The Board refused the Bank's application for eviction, arrears of rent and termination of a tenancy for non-payment of rent. The respondent (the tenant) had entered into a one-year written tenancy agreement and had pre-paid the rent for the one-year period. The owner defaulted on the mortgage. The Bank became the mortgagee-in-possession, pursuant to the *Mortgages Act*, R.S.O. 1990, c. M.40, on August 29, 2007.

The Issues

3 The following issues are raised:

- What is the obligation to a tenant of a mortgagee-in-possession pursuant to s. 47 of the *Mortgages Act*?
- Did the Board err in applying s. 106(2) of the *Residential Tenancies Act, 2006*, S.O. 2006, c. 17 ("the *RTA*")?
- Did the Board err in finding that the prepayment was a covenant that runs with the land binding upon the Bank?

Court's jurisdiction and standard of review

4 Pursuant to s. 210 of the *RTA*, a party may appeal an order of the Landlord and Tenant Board to the Divisional Court, but only on a question of law.

5 The standard of review of an appeal from a decision of the Landlord and Tenant Board on a question of law is correctness (*Dollimore v. Azuria Group Inc.* (2001), 152 O.A.C. 57 (Ont. Div. Ct.); *Bielak v. Clarke* (2008), 241 O.A.C. 259 (Ont. Div. Ct.)).

The statutory provisions in issue

6 There are conflicting decisions with respect to the issues raised in this appeal. There is no decision by this Court interpreting the appropriate interrelationship of the statutory provisions of s. 47 of the *Mortgages Act* and s. 106 of the *RTA*.

7 Section 47 of the *Mortgages Act* provides:

Person deemed to be landlord

47. (1) A person who becomes the mortgagee in possession of a mortgaged residential complex which is the subject of a tenancy agreement between the mortgagor and a tenant or who obtains title to the residential complex by foreclosure or power of sale shall be deemed to be the landlord under the tenancy agreement.

...

(3) A person who is deemed to be a landlord is subject to the tenancy agreement and to the provisions of the Residential Tenancies Act, 2006 which apply to residential complex.

[Emphasis added.]

8 Section 47 is clear: a mortgagee-in-possession steps into the shoes of the landlord, is deemed to have adopted the rights and obligations of the landlord, and is subject to the tenancy agreement and the provisions of the *RTA*.

9 There is no provision in the *RTA* stipulating that rent must be paid on a monthly basis. However, sections 105 and 106 of the *RTA* limit the right of a landlord to collect a security deposit to a maximum amount of one month's rent.

Security deposits, limitation

105. (1) The only security deposit that a landlord may collect is a rent deposit collected in accordance with section 106.

Definition

(2) In this section and in section 106,

"security deposit" means money, property or a right paid or given by, or on behalf of, a tenant of a rental unit to a landlord or to anyone on the landlord's behalf to be held by or for the account of the landlord as security for the performance of an obligation or the payment of a liability of the tenant or to be returned to the tenant upon the happening of a condition.

Rent deposit may be required

106. (1) A landlord may require a tenant to pay a rent deposit with respect to a tenancy if the landlord does so on or before entering into the tenancy agreement.

Amount of rent deposit

(2) The amount of a rent deposit shall not be more than the lesser of the amount of rent for one rent period and the amount of rent for one month.

Same

(3) If the lawful rent increases after a tenant has paid a rent deposit, the landlord may require the tenant to pay an additional amount to increase the rent deposit up to the amount permitted by subsection (2).

Qualification

(4) A new landlord of a rental unit or a person who is deemed to be a landlord under subsection 47 (1) of the Mortgages Act shall not require a tenant to pay a rent deposit if the tenant has already paid a rent deposit to the prior landlord of the rental unit. [Emphasis added.]

Background Facts

10 The respondent, John MacPherson, entered into a one-year written tenancy agreement to lease a house in Newmarket with Sandra Wilson, the owner. The lease was negotiated by a rental agency.

11 The rent was \$2,000 per month, and the tenant was required to pay a deposit of \$2,000. The tenant paid the deposit. The tenant also pre-paid the entire year's rent of \$24,000, prior to taking possession on June 15, 2007. The tenant received a discount in the amount of \$4,800.00 as consideration for pre-paying one year of rent.

12 The rent pre-payment was a term of the lease:

28. The Tenant hereby agrees to pre-pay the entire yearly rent and for so doing, he acknowledges that he is receiving a \$4,800.00 discount. The Tenant agrees to pay a further \$2,000.00 on June 1st and the balance of \$20,000.00 on June 15, 2007.

13 The tenant was unemployed at the time he entered into the lease, but had a lump sum available from the sale of his former home. He was prepared to pay for rent for the entire year, as he may not have qualified for a traditional monthly lease, and he wished to pursue custody of his child and needed stable accommodation.

14 Sandra Wilson defaulted on her mortgage. The Bank served a Notice of Attornment of Rent on the tenant on August 29, 2007. On October 26, 2007 the Bank filed an application with the Board seeking arrears of rent in the amount of \$4,800 for September and October 2007, and sought an order for the eviction of the tenant.

The Board Decision

15 The Board concluded that when a mortgagee is in possession, the tenant should be given credit for any *bona fide* prepayment of rent to the landlord. The Board noted that case law dealing with a predecessor provision to s. 105 of the *RTA*, being s. 82 of the *Landlord and Tenant Act*, R.S.O. 1990, c. L.7 (*LTA*), held that the purpose of the limited security deposit was, in part, to protect tenants. Notwithstanding that the tenant had paid a security deposit in excess of one month's rent by pre-paying the rent, the Board concluded that the statutory provisions should be interpreted in light of the clear purpose of the legislation. It held that the Bank was bound by the terms of the lease under ss. 47 and 48 of the *Mortgages Act*, and because the prepayment was a covenant that runs with the land, it is binding upon mortgagees-in-possession, according to s. 18 of the *RTA*.

16 The Board noted that the tenant had filed copies of money orders and rent receipts issued by a rental agency, proving that he had paid \$24,000 to the landlord, Sandra Wilson. It also noted that the Bank acknowledged the rent was paid, the parties to the lease were at arms' length, and that the pre-payment was *bona fide*.

17 The Bank argued before the Board and in this appeal that the maximum amount a landlord can accept as a rent security deposit is an amount equal to one month's rent in accordance with ss. 105 and 106 of the *RTA*. Pre-payment of rent is in essence a security deposit for future rent. Since \$24,000 exceeds the rent for one month, the pre-payment was in contravention of the *RTA*. The Bank argued before the Board, unsuccessfully, that the lease term was illegal as it contravened s. 106 of the *RTA*, and therefore the tenant could not rely upon it in defence of the Bank's claims.

18 The Bank relied upon the decisions of *Royal Bank v. Boutis*, [1994] O.J. No. 1199 (Ont. Gen. Div.) and *CIBC Trust Corp. v. Mullings*, [1996] O.J. No. 197 (Ont. Gen. Div.). These decisions concluded that if the tenant has prepaid the rent to the landlord, and the landlord subsequently defaults on the mortgage, that the mortgagee-in-possession may pursue the tenant for the rents prepaid

19 The Board declined to follow the decisions of *Boutis* and *Mullings*, which create an obvious hardship to the tenant.

20 The tenant relied upon *Royal Trust Corp. of Canada (Trustee of) v. Parmentier*, [1996] O.J. No. 162 (Ont. Gen. Div.). *Royal Trust Corp. of Canada (Trustee of)* was decided solely considering ss. 47(1), 47(3) and 48(1) of the *Mortgages Act* and did not consider the provisions of the *Tenant Protection Act* in force at the time. The court in *Royal Trust Corp. of Canada (Trustee of)* held that the prepayment of rent was a covenant that ran with the land, and as such, the mortgagee-in-possession was bound by the prepayment. Since the mortgagee-in-possession was the deemed landlord, the tenant was entitled to credit for the payment against the landlord in both law and in equity.

21 The Board agreed with the tenant's submissions. It noted that the limits on security deposits were designed to protect tenants before they enter into a tenancy agreement from unreasonable demands of landlords, and it would be unfair not to give credit to the rental prepayment made in good faith. It held the prepayment was binding on the mortgagee-in-possession as a covenant running with the land.

22 The tenant remained in possession until the one-year lease expired and has since vacated the premises. The Bank has an agreement with the tenant that if it is successful in this appeal, it will not seek any recourse against the tenant. The tenant did not file any materials in response to the appeal by the Bank.

Issue 1: What is the obligation to a tenant of a mortgagee-in-possession pursuant to s. 47 of the *Mortgages Act*?

23 The language of s. 47(1) and (3) of the *Mortgages Act* is specific. The mortgagee-in-possession is deemed to be the landlord, and the deemed landlord is "subject to the tenancy agreement and to the provisions of the *Residential Tenancies Act, 2006* which apply to residential complex."

24 The pre-paid rent was a term of the tenancy agreement. Counsel for the Bank acknowledges that the owner could not have pursued the tenant for non-payment of rent in the circumstances of this case. In accordance with the words of the *Mortgages Act*, the mortgagee-in-possession can have no higher right than the owner/landlord.

Issue 2: Did the Board err in applying s. 105 and s. 106(2) of the *RTA*?

25 The Bank argues that the term for the pre-payment of rent is void and unenforceable by the tenant because of ss. 105 and 106 of the *RTA*, which prohibit rental deposits of more than one month's rent.

26 I disagree with this argument for two reasons.

27 First, the plain language of these sections does not make pre-payment by a tenant of a rent in excess of one month's rent illegal. It makes the act of a landlord demanding such prepayment illegal. Moreover, s. 234(d) of the Act makes it an offence for a person to require or receive a security deposit *from a tenant* contrary to s. 105. The tenant does not commit an offence in paying more than one month's rent in advance.

28 Second, even assuming that ss. 105 and 106 mean that any prepayment of rent falls within the definition of a security deposit and therefore any amount paid over one month's rent is *prima facie* illegal, this does not mean that the tenant is precluded from relying on his prepayment of rent when faced with a demand for rent by the mortgagee-in-possession.

29 The decisions of *Boutis* and *Mullings* were decided without reference to the more purposive and principled approach to statutory illegality that has been adopted by courts. Moreover, *Boutis* relied on the case of *Chiappino v. Bishop* (1988), 49 R.P.R. 218 (Ont. Dist. Ct.), which has been rejected by a number of other decisions. See, for example, *Spencer Properties Ltd. v. Zrebiec*, [1992] O.J. No. 2944 (Ont. Gen. Div.); *Top Link Investments Ltd. v. Hutchinson* (1997), 37 O.R. (3d) 107 (Ont. Gen. Div.); and *Royal Trust Corp. of Canada (Trustee of)*, *supra*. *Mullings* followed *Boutis*.

30 It was once the case that an illegal contract was always unenforceable, and no relief from the courts could be claimed by one who entered an illegal contract. The modern approach is not so categorical. See: John McCamus, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005) at pp. 459-467. When a provision of a contract is *prima facie* illegal, it is incumbent on courts to assess the purpose behind the statutory prohibition and determine the consequences in light of that statutory purpose when determining whether the contract is unenforceable. As stated in *Still v. Minister of National Revenue* (1997), [1998] 1 F.C. 549 (Fed. C.A.) at para. 48:

Where a contract is expressly or impliedly prohibited by statute, a court may refuse to grant relief to a party when, in all of the circumstances of the case, including regard to the objects and purposes of the statutory prohibition, it would be contrary to public policy, reflected in the relief claimed, to do so.

31 Morden, J.A. in *Reliable Life Insurance Co. v. M.H. Ingle & Associates Insurance Brokers Ltd.* (2002), 59 O.R. (3d) 1 (Ont. C.A.) confirms that the policy of the statutory regime and facts of the case are important in assessing enforceability of a contract (at para. 42):

It would be wrong to say that the law respecting the enforceability of contracts that contravene a statute is clear and that the decisions in the cases are all consistent. Much turns on the particular terms of the statute, its underlying policy, and the facts of the case at hand.

32 The goal of ss. 105 and 106 of the *RTA*, as recognized by the cases, is to protect tenants from landlords demanding large sums of money to be paid in advance in order to secure housing: *Mullings*, *supra* at para. 5.

33 In this case, the tenant voluntarily negotiated the terms of a lease for the pre-payment of rent which suited his personal circumstances to prove that he had stable accommodation for his child for a one year period, and provided him with a significant discount as compensation for pre-paying his rent.

34 Sections 105 and 106 of the *RTA* provide a statutory mechanism for a tenant to *resist demands* for sums greater than one month's rent as a security deposit. They cannot, practically speaking, prevent tenants from paying sums in advance, especially since a lay person reading the provision would not likely view any prepaid rent as a "security deposit" captured by the provisions. Moreover, to treat an agreement under which a tenant has prepaid rent to his or her landlord as unenforceable would penalize the very party the provisions of the Act are meant to protect: *Kiriri Cotton Co. v. Dewani* (1959), [1960] A.C. 192 (East Africa P.C.).

35 The Bank argues that s. 4 of the *RTA* makes it clear that a provision in a tenancy agreement that is inconsistent with the Act is void, and therefore, the prepayment provision is unenforceable. It states that subject to s. 194, "a provision in a tenancy agreement that is inconsistent with this Act of the regulations is void". I agree that s. 4 would prevent a landlord from enforcing a term of an agreement requiring prepayment of rent beyond one month. However, s. 4 does not address the consequences when a tenant has prepaid all his rent.

36 It is noteworthy that s. 135(1) of the *RTA* provides a remedy to a tenant against a landlord who has collected money in contravention of the Act. It allows the tenant to apply to the Board to recover such funds. This provision shows that the Legislature did not intend a tenant to be without recourse where a provision of a tenancy agreement, such as a requirement for prepaid rent, is contrary to the Act.

37 Given the terms of s. 135(1), it would be consistent with the purpose of the Act to allow a tenant to rely on the terms of a tenancy agreement against a landlord who had received rent payments in advance if the landlord were to argue that the agreement was illegal and unenforceable.

38 The Bank argues that the decisions *Boutis* and *Mullings* confirm that an additional goal of ss. 105 and 106 is to protect landlords against spurious claims of tenants. I disagree. The plain wording of ss. 105 and 106 binds the landlord, not the tenant. Other cases have specifically held that the restrictions on security deposits are exclusively for the protection of the tenant: *Mullings, supra*; *Boyd v. Earl & Jennie Lohn Ltd.* (1984), 47 O.R. (2d) 111 (Ont. H.C.). In any event, in this case, there is no allegation that this is a spurious claim by the tenant.

39 The Bank also argues that the modern purposive approach to illegal contracts is available as between the parties to the contract, perhaps to avoid unjust enrichment, but it is not an appropriate tool against the Bank, an innocent third party who did not participate in or benefit from the agreement.

40 The Bank argues that the responsibilities of the mortgagee-in-possession as a landlord is limited to the period when the mortgagee became landlord, and therefore it is not responsible to the tenant for liabilities which occurred during the tenure of the original landlord. This proposition is said to be supported by *981673 Ontario Ltd. v. Jessome* (1994), 21 O.R. (3d) 343 (Ont. Gen. Div.); *Prenor Trust Co. of Canada v. Forrest*, [1993] O.J. No. 1058 (Ont. Gen. Div.); and *Graff v. Dama* (1995), 53 A.C.W.S. (3d) 622 (Ont. Gen. Div.) [1995 CarswellOnt 2428 (Ont. Gen. Div.)].

41 These cases are not helpful. Of the three, only *Jessome* deals with advance rent, and relies upon *Boutis*. For reasons previously outlined, I conclude on the facts of this case that *Boutis* is no longer determinative. *Prenor* and *Graff* deal with claims for an abatement of rent. It may be that a tenant's claim for an abatement of rent against the mortgagee-in-possession will be limited in time to that period when the mortgagee became the landlord, but this is a very different issue than the one before this court. Section 47 of the *Mortgages Act* is not discussed in the analysis in *Prenor* and *Graff*.

42 Section 47 of the *Mortgages Act* makes it clear that the Bank steps into the shoes of the landlord/owner at the date it assumes possession. As the tenant here prepaid his rent to the landlord, the Bank has no right to claim further rent from him. The Bank has recourse against the owner for any shortfall in the rents. Therefore, the Board did not err in its application of ss. 105 and 106 of the *RTA*.

Issue 3: Did the Board err in finding that the prepayment was a covenant that runs with the land binding upon the Bank?

43 The Board ordered the Bank's application to be dismissed as it found that it would be unfair if the tenant could not get the benefit of the prepayment and the agreement to honour the prepayment was a covenant "concerning things related to a rental unit" and therefore, according to s. 18 of the *RTA*, the covenant ran with the land. As such, the covenant was binding upon the mortgagee-in-possession.

44 A covenant which runs with the land is binding upon the successive owners of the property, so that they can take the benefit of the agreement and are liable for any obligations it imposes. The effect of the doctrine was explained by Craig R. Carter,

"Assignments of Contracts, Novation, and Privity" in *Law Society of Upper Canada, Special Lectures 2002: Real Property Law: Conquering the Complexities*, (Toronto: Irwin Law, 2003) at 53-54:

In privity of estate, the benefit of the covenants that touch and concern the land run with the land and are enforceable by, and against, an assignee of the interest in the land. The covenants that touch and concern the land attach to the land and bind the owner of the land from time to time. Accordingly, where A enters into a lease with B and agrees to provide quiet possession of the property to B and where A assigns or transfers the land to C, even though C is a stranger to the lease and does not assume the obligations of A under the lease, the law will force C to honour the covenant for quiet possession that runs with the estate in land held originally by A and assigned to C. Where a lease is assigned by the tenant B to C, A the landlord can enforce the obligation to pay rent as against C because the covenant to pay rent touches and concerns the land.

45 *Black's Law Dictionary*, 6th ed., gives a succinct outline of the requirements of a "covenant running with the land":

Essentials of such a covenant are that the grantor and grantee must have intended that the covenant run with the land, the covenant must affect or concern the land with which it runs, and there must be privity of estate between the party claiming the benefit and the party who rests under the burden.

46 In *Westboro* the court found that the obligation to honour the prepayment of rent was binding on the mortgagee-in-possession because of s. 47 of the *Mortgages Act*, and that if necessary, it would hold that the original landlord and tenant had intended the obligation to honour the prepayment to run with the land. No tenant would pay rent on a yearly basis otherwise, so this implied intention is reasonable.

47 This analysis applies equally here, and the Board did not err in so finding.

Conclusions

48 The specific terms of s. 47 of the *Mortgages Act* determine the issues between the parties notwithstanding s. 106(2) of the *RTA*. The mortgagee-in-possession is bound by s. 47(3) to the terms of the lease and the *RTA*, and is deemed to be the landlord. Therefore, the Bank is required to respect the term respecting the prepaid rent and cannot seek an order for payment of rent already paid, or an order for eviction.

49 The Board did not err in interpreting sections 105 and 106 of the *RTA*.

50 Notwithstanding sections 105 and 106 of the *RTA*, the term of the lease for the prepayment of rent is a covenant that runs with the land and is binding on the mortgagee-in-possession.

51 For these reasons, the Bank's appeal is dismissed.

52 No order as to costs.

Appeal dismissed.