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Tenant Utility Arrears: Another Surprise Cost of Property Ownership?

by Marc Kemerer

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Background to the Issue

In 2001 the *Municipal Act* in Ontario was completely revamped, becoming the *Municipal Act*, *2001* (the "Act"). As part of those changes, many of the provisions of the *Public Utilities Act* (the "Utilities Act") were repealed and brought within the ambit of the Act.

Little noticed among the changes at that time was the inclusion of a provision in the Act allowing municipalities to add utility arrears incurred by a tenant to the tax bill of the property owner. Section 398(2) of the Act provides that a local municipality may, and upon the request of a local board, shall, add fees and charges imposed by the municipality or local board to the tax roll. In the case of debts owed to a public utility, those debts may be added to the tax roll of the property to which the public utility was supplied. What this means is that property owners may be burdened with utility arrears they have no control over.

Ontario Regulation 581/06 permits fees and charges for the supply of water, gas, steam or hot water, sewage and/or waste management placed on the tax roll to have priority lien status under the Act. This provides a municipality with a number of means of collection in addition to the sale of land for tax arrears (which requires a three year wait on the part of the municipality), including by going to court to enforce the debt or by seizing personal property in the possession of the taxpayer.

The addition of this particular provision reversed the law in this area as established by court decisions holding that it was not reasonable that a landlord should guarantee a utility charge where the landlord was not the consumer: see for example the 1998 decision of the Ontario Court of Appeal in *710357 Ontario Limited and 840703 Limited v. The Corporation of the Town of Penetanguishene* and the 1991 decision of the Ontario Court of Justice in *Bracebridge Hydro Electric Commission v. 796479 Ontario Limited c.o.b. Riverside Apartments*.

Municipal Policies Adding Utility Arrears to the Tax Bill

The recent decision of City of Cambridge Council at its meeting of 13 December 2010 to adopt a water and wastewater policy adding any such default payments to the tax roll of the property owner has brought this issue to the fore. This policy applies to all new utility accounts in Cambridge established on or after 1 January 2011. From that date on any new (waste)water accounts will be established only (a) with the owner(s) of a property or (b) the tenant where the tenant pays a deposit of $230 and has entered into a signed agreement with the landlord whereby the landlord acknowledges that any arrears in excess of the deposit shall be added to the tax roll.

An attempt by one Cambridge Councillor to rescind this policy (on the basis of fairness) was defeated at the Council meeting on 14 February 2011. The Province, by way of a letter dated 26 January 2011 to the Federation of Rental-Housing Providers of Ontario, has indicated that it will not be taking any action on this issue.

What is interesting is that section 50(4) of the Utilities Act recognizes that the consumer is the person or entity who is responsible for providing the deposit (i.e. the tenant under the new Cambridge policy) whereas the Act deems that the property owner is the consumer. This facilitates collection for municipalities and their utilities but visits an unfairness on the property owner.

Similar policies are in place in a number of other municipalities within the Greater Toronto Area and may involve services other than water. These policies will have very serious, potentially catastrophic, impacts on property owners and have serious implications for potential purchasers of property as purchasers may inherit liabilities that will show up as a surprise on the tax bill.

The New Due Diligence

Property owners, purchasers and even tenants need to make themselves aware of any municipal policies that allow utility arrears to be added to the tax roll. They also need to be aware as to whether they can obtain information on the status of individual utility accounts. This should prove difficult as utilities will likely refuse to answer any such queries on privacy grounds without written authorization from the tenant.

Property Owners; Commercial, Office and Industrial Tenancies

It is difficult to overstate the magnitude of the potential change in the allocation of contingent risk of financial loss from utility arrears as between landlords and tenants in Ontario posed by the amendments to the Act, as reflected by the City of Cambridge policy noted above.

The over whelming majority of all leases in Ontario falling within the categories noted above are intended by the parties to allocate all risk of any costs of occupation to tenants, save and except in extremely narrow areas such as structural building defects, and other expressly noted "carve outs" which reflect the relative negotiating strength of the parties to a lease. The existence of so called "triple net" leases is the industry norm.

Landlords will need to consider how best to address this issue of tenant utility arrears being thrust upon them in existing tenancies and in all future tenancies. To do this, they need to identify present municipal policies on tenant utility arrears in any jurisdiction, and in the absence of such an express policy, the risk of the imposition in the future of a Cambridge-type utility arrears policy .

As a starting point, landlords should immediately contact the municipality in all jurisdictions where they hold property to determine what the existing municipal policy is in respect of tenant utility arrears . These individual municipal policies should be confirmed in writing by the landlord to the applicable municipalities with a request to be advised in writing (with commercially reasonable notice and in advance) if the municipal policy in respect of tenant utility arrears is to change. Such correspondence should expressly note the importance of this issue to landlords as lease contracts may need to be revised to continue to reflect the parties agreement as to "triple net" nature of almost all such leases in these types of tenancies. The correspondence should also be clear that, in the event the municipality fails to notify the landlord of such a policy change, the landlord will rely on the correspondence as a form of estoppel to prevent the municipality from adding arrears to the tax bill.

With respect to existing tenancies, landlords should act promptly to complete lease reviews of every lease to determine whether there is any ability under the terms of existing leases to: enforce a request to obtain current information as to the status of tenant utilities; interrupt the supply of utilities to a

tenant without liability, and; recover any sums paid to a utility by a landlord from tenants in respect of utility consumption in the event of a failure of any tenant to make payment of utilities.

This landlord tenancy review process will no doubt involve:

1) a classification as to risk having regard to each tenancy's historical consumption of utilities, and the remaining length of term in any lease;

2) a consideration of the strength of each tenancy's financial covenant in respect of the ability to ultimately recover from the applicable tenant unpaid utility arrears falling to the landlords account;

3) identifying, on a per tenancy basis, leases which contain sufficient generic rights to address these contingent financial risks by way of provision of information and effective ability to obtain financial redress;

4) developing a strategy in respect of high risk tenancies and inadequate leases to seek voluntary compliance, and, before any issues exist, with prospective policies designed to address these contingent utility account eventualities. This may include landlord requests for things like: joint requests(from tenants and landlords) to have utilities provide, without any admission of liability by landlords to pay such sums duplicate copies of utility accounts to landlords by email; voluntary production to landlords by tenants of true copies of monthly utility accounts akin to the processes routinely in place to monitor gross sales on monthly or quarterly basis; joint requests to utility providers to notify landlords in the event that tenant utility accounts go into arrears, or exceed a certain agreed amount of arrears; limited powers of attorney granted by tenants to landlords for the purposes of obtaining utility account information; utility account deposits held by utilities or landlords; lease amendments to include specific utility account provisions, etc.; and

5) identifying, for property managers and property accountants, priority tenancies requiring monthly scrutiny.

As a practical matter, while some tenants will likely be fairly co-operative with landlords requests for voluntary compliance with new policies to address these issues, seeing no down side to such policies or lease amendments as this class of tenants have no problem paying all utilities and confirming such payments, others will no doubt resist any such landlord initiatives. Also it is unclear whether utilities will see proposals such as those noted above as simply an unwanted administrative burden, or will welcome them as a *bona fide* co-operative tool to minimize defaulting utility accounts.

Once the dust settles and landlords have prioritized high risk tenancies, sought voluntary compliance with their initiatives and engaged utility providers in this exercise designed to minimize defaulting utility accounts, a group of problematic existing tenancies will continue which will require enhanced monitoring by landlords and property managers.

Over time as these remaining tenants seek landlord consent to lease amendments such as to assign, sublet, change corporate control, change use, permit financing with priority over distraint etc, landlords should consider whether, as a term of granting consent, they are lawfully entitled to require lease amendment to address the issues arising out of the risk of tenant utility arrears. This is an area which requires careful analysis of parties rights and obligation under leases, the common law and the *Commercial Tenancies Act*.

In respect of every new tenancy, landlords would be well advised to ensure any offer to lease or lease specifically addresses the issues created by tenancy default in payment of utilities. Specific lease terms should be drafted to allocate risk in accordance with the intentions of the parties .

Property Owners: Residential Tenancies

While the amount of arrears will generally be more of a concern for commercial, office and industrial landlords, given the size and nature of their tenants, those landlords have more of an ability to limit their exposure than owners of residential property. Under the *Residential Tenancies Act*, the only deposit that a landlord may legally require from a tenant is one month's advance rent. Accordingly, residential landlords faced with the addition of utility arrears to their property tax bill will have to be creative, for example by seeking a higher rent for a unit, or they may have to go to court to recover the costs. In this respect there should be a provision in the lease where the tenant indemnifies the landlord for any outstanding utility costs. Pursuing an action through the courts however may cost more than the actual recovery will net, and the tenant may have disappeared or not be in a financial position to cover the arrears at any point.

Purchasers

Where a municipal policy allowing for the imposition of utility arrears on the property tax bill exists, purchasers should determine whether they are able to obtain information from utilities on the state of an account where they are not the listed consumers. For a potential purchaser, wording to address this issue, for example an indemnity, may need to be included in any agreement of purchase and sale or a specific requirement to obtain authorization from such tenants. A vendor will want to respond with caution to such wording. A purchaser may also want to see the wording of any existing leases to determine the extent of any future liabilities.

Tenants

Finally, the above concerns on the part of landlords will clearly impact the potential costs of leasing a premises. It will also be an important issue for tenants where a property is multi-tenanted and all tenants are required to share in the costs of the provision of the utility. Tenants may find that they have to subsidize the consumer habits of a defaulting tenant. Such potential liability should shape a tenant's approach to leasing space as tenants will have to determine what billing set up and deposit they are willing to accommodate.

Insurance

For those wondering if insurance might be available, the typical professional liability and Directors & Officers' liability policy will not usually cover tax liabilities. Typically, this is either outside the definition of "Loss" or dealt with by way of specific exclusion for penalties, fines and taxes. What a purchaser might want to look at is whether their title insurance will cover a circumstance where the arrears existed prior to the purchaser acquiring title.

Conclusion

Even if the sky for property owners, purchasers and tenants is not be falling under the contingent financial exposure and weight of unpaid utility arrears, this is an area that clearly merits attention and creative, sound, strategies. We would be happy to answer any queries you may have on this topic. ■

The author wishes to thank John Wolf of Blaney McMurtry LLP for his considerable contributions to this article. John is a senior partner in the Blaneys Commercial Litigation Group, and his practice specializes in advising major landlords and tenants in issues arising out commercial, industrial, and office tenancies. The author also wishes to thank other partners at Blaney McMurtry LLP who provided assistance with this article: John Brunt, Maureen Merrill, Marcus Snowdon, Shawn Wolfson and Jeffrey Freelan.