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Consultation Paper
on

Leases of Unsubdivided Land and The Top Line Case

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(b) promote improvement of the administration of justice and respect for the rule of law, and
(c) promote and carry out scholarly legal research.

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I. INTRODUCTION

The British Columbia Court of Appeal's decision in *International Paper Industries Ltd.* v. *Top Line Industries Inc.*[1] has caused a considerable stir. When the decision was rendered in 1996 it was greeted with surprise, criticism, and concern. One commentator called for legislation, ". . . so that the problem raised by this decision can be eliminated."[2] The purpose of this Consultation Paper is to determine whether support for legislative action in response to the *Top Line* case continues to exist.

II. SUMMARY OF THE *TOP LINE* CASE

The court's interpretation of section 73 of the *Land Title Act*[3] was at the heart of *Top Line*. The relevant parts of section 73 for the case were:[4]

> **Restrictions on subdivision**
>
> **73** (1) Except on compliance with this Part, a person must not subdivide land into smaller parcels than those of which the person is the owner for the purpose of
>
> (a) transferring it, or
>
> (b) leasing it, or agreeing to lease it for a life, or for a term exceeding 3 years.
>
> . . .
>
> (3) Subsection (1) does not apply to a subdivision for the purpose of leasing a building or part of a building.
>
> . . .
>
> (6) An instrument executed by a person in contravention of this section does not confer on the party claiming under it a right to registration of the instrument or a part of it.

Top Line was concerned with the consequences of entering into a document that purports to be a lease but that does not comply with the restrictions on subdivision established by section 73.

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1. (1996) 135 D.L.R. (4th) 423, [1996] 7 W.W.R. 179, 20 B.C.L.R. (3d) 41 (C.A.), Newbury J.A. (for the court) [*Top Line* cited to B.C.L.R.].

2. Bruce D. Woolley, "Case Comment: *International Paper* v. *Top Line Industries*" (1996) 54 Advocate 915 at 917.

3. R.S.B.C. 1996, c. 250.

4. This quotation is taken from the 1996 revised statutes. It differs slightly in expression and subsection numbering from the version of section 73 that the court considered in *Top Line*, but in substance it is the same.

In *Top Line*, International Paper Industries Ltd. (the "Tenant") owned a building from which it carried on a waste recycling business. The Tenant entered into an agreement with Top Line Industries Inc. (the "Landlord"). The Landlord agreed to purchase the tenant's building and to move it onto the Landlord's property. The Landlord and the Tenant signed a document that purported to be a lease of an unsubdivided part of the Landlord's land (the "Lease"). The term of the Lease was 51 months. Despite having a term in excess of three years, nothing in the Lease, which was prepared by the parties without legal advice, addressed registration in the land title office. Further, nothing in the Lease dealt with obtaining subdivision approval. Apparently neither the Landlord nor the Tenant was aware of the requirements of section 73.

The relationship between the Landlord and the Tenant deteriorated after the Lease was signed. Two disputes between the parties ended up in court. These disputes were resolved in the Tenant's favour. With the expiry of the term of the Lease approaching, the Tenant decided to renew it. In accordance with the provisions of the Lease, the Tenant sent the Landlord a written request for renewal. The Landlord refused to renew the term. The Tenant petitioned the Supreme Court for a declaration of the Lease's validity and of the Tenant's entitlement to renew it, setting in motion the proceedings that would end up in the Court of Appeal.

At the hearing of the petition[5] the Landlord argued for the first time that the Lease was unenforceable or void, due to its noncompliance with section 73. The chambers judge reviewed three earlier cases that had considered section 73.[6] He regarded himself to be bound by what he took to be their conclusion: a document purporting to be a lease that is not in compliance with section 73 confers no rights in land, but may create personal rights and obligations between the parties to it. As a result, the chambers judge declared the Lease to be enforceable as a personal contract, which created binding obligations for the Landlord and the Tenant.

The Court of Appeal rejected the chambers judge's conclusion on the earlier cases that considered section 73. It decided that the three cases cited by the chambers judge either did not address the question of whether a document that contravenes section 73 confers personal rights and obligations on the parties to it, or, to the extent that these cases came to that

5. *International Paper Industries Ltd.* v. *Top Line Industries Inc.*, (1994) 93 B.C.L.R. (2d) 135, 38 R.P.R. (2d) 194 (S.C.), Tysoe J.

6. *Nesrallah* v. *Pagonis*, (1982) 136 D.L.R. (3d) 762, [1982] 5 W.W.R. 175, 38 B.C.L.R. 112 (S.C.), Taylor J.; *Yorkshire Trust Co.* v. *Gunter Farms Ltd.*, (1987) 47 R.P.R. 216 (B.C.S.C.), Hutchinson L.J.S.C., *aff'd*, (1989) 40 B.C.L.R. (2d) 161 (C.A.); *Anglican Synod of the Diocese of British Columbia* v. *Tapanainen*, [1990] B.C.J. No. 1164 (S.C.) (QL), MacKinnon J.

conclusion, they were wrongly decided.[7] In the court's view, then, there was no definitive case authority on the effect of a contravention of section 73.

Since section 73 does not spell out the consequences of breach—beyond providing that a document in breach of the section cannot be registered in the land title office—and since there was no binding past authority, the court said it was necessary to examine the policies underlying the provision. The court identified two policies: first, ". . . to ensure that municipal authorities retain control over subdivision as a means of regulating zoning, drainage, utility supply, building encroachment, siting, local aesthetics, and land development and use generally in the public interest";[8] and, second, "to ensure the operation of the Torrens land registration system in this Province."[9] The court held that section 73 deserved an expansive interpretation in order to sustain its underlying policies.

After the court identified the policies advanced by the legislation, it was ready to address the key question raised by this lawsuit: "[d]oes a lease executed by the parties in ignorance of this provision [*i.e.* section 73] create any equitable interest in respect of the land, or any contractual interest, or is such a document void *ab initio*?"[10] The Tenant put forward three arguments, each phrased as alternatives to the others, to convince the court to reject the third choice in favour of the first or the second. It asked the court to imply a condition precedent to the Lease, which would require the Landlord to comply with section 73. It requested that the court fashion a licence of occupation from the Lease, which would give the Tenant rights to possession and occupation of the premises but would not confer any interest in the land. Finally, it argued that the Landlord should be estopped from raising the validity of the Lease as an issue in this case because the Landlord failed to raise this issue in the two previous lawsuits involving the Lease.

The court rejected each argument. It refused to imply a condition precedent to the Lease because ". . . such terms may involve major expense and the Court cannot be confident that had the parties thought of the subdivision issue, they would have provided for it in a particular way."[11] The court then weighed the second and third arguments against the policies underlying section 73 and found, in both cases, that it could not accept the argument with-

7. *Supra* note 1 at para. 15.

8. *Ibid.* at para. 17.

9. *Ibid.* at para. 18.

10. *Ibid.* at para. 22.

11. *Ibid.* at para. 31.

out undermining the policies.[12] As a result, the court "with some regret" set aside the decision of the chambers judge and found the Lease to be void *ab initio*.[13]

III. CRITICISMS OF THE *TOP LINE* CASE

Lawyers and others expressed concerns about this finding of invalidity almost immediately after *Top Line* was decided. These concerns can be divided into two types. First, a number of commentators have criticized the court's reasoning in arriving at the result in *Top Line*. Second, several critics have worried about the effect that the decision would have both on existing leases and on leases concluded after *Top Line*.

The most commonly-heard complaint about the reasoning in *Top Line* was, as one commentator put it, that "[t]he court overstated the evils which s. 73 seeks to restrain."[14] Another critic remarked, "[t]here has been no demonstrable harm"[15] caused by leases in contravention of section 73. The damage has been contained because restrictions on subdivision are not the only tool that local governments have to control real estate development. The forerunner of section 73 was enacted in 1919. Since that time, local governments have imposed numerous licence and permit requirements—such as building permits and business licences—in order to regulate land use and development. In addition, zoning requirements have progressed since 1919. As a result, restrictions on subdivision are no longer the only or even the primary means that local governments have at their disposal to control real estate development.

It has also been observed that an arrangement that is substantially similar to the one in *Top Line* could be achieved by other means. For example, a landlord can enter into a lease of a building with a tenant and grant that tenant an easement or a licence over part of the remaining land. By finding the lease in *Top Line* to be void, the court could be said to be favouring form over substance.[16]

Leases such as the one in *Top Line* also appear to pose little threat to the integrity of the land title system. Since such leases cannot be registered, there is no practical encouragement to enter into them. It is difficult to raise funds from lenders on the strength of an

12. *Ibid.* at para. 35, para. 40.

13. *Ibid.* at para. 41.

14. Ashley F. Hilliard, "Commercial Leases," in Continuing Legal Education Society of British Columbia, *Business Law Practice '98 Update* (Vancouver: Continuing Legal Education Society of British Columbia, 1998) 5.1 at 5.1.14.

15. Woolley, *supra* note 2 at 517.

16. *See* Hilliard, *supra* note 14 at 5.1.14.

unregistered lease. Absent fraud, a subsequent purchaser of the land will take title to it unencumbered by the lease. Finally, the *Land Title Act* does not dictate the harsh result of invalidity; it only provides that such leases cannot be registered.

Critics have questioned other aspects of the reasoning in *Top Line*. One lawyer has argued that *Top Line* was wrongly decided because it failed to consider relevant statutory provisions.[17] Absent an agreement to the contrary, sections 5 and 7 of the *Property Law Act*[18] require a landlord to provide a tenant, under a lease with a term in excess of three years, with a registrable lease. In order to do this, the landlord must carry out the steps required for a valid subdivision of the property. These statutory provisions have an effect similar to the implied term discussed and rejected in *Top Line*. They remove the taint of illegality from the Lease.[19] Another lawyer has argued that the court misapplied the doctrine of *res judicata* in *Top Line*.[20] According to this argument *Top Line* was wrongly decided because ". . . the court should have held that once a case of *res judicata* was made out the cause of action disappeared and no public policy could save it, even one embodied in a statutory provision such as section 73."[21]

Other criticisms of *Top Line* have focussed on the effect that the decision could have on commercial leasing. The court touched on these concerns when it referred to ". . . the desirability of holding parties to their contractual obligations. . . ."[22] A declaration that an agreement is void *ab initio* can cause a disaster for one party and a windfall for the other. This result appears to have occurred in *Top Line*, where the Landlord ended up with vacant possession of the Tenant's building.[23] Even in the absence of such a windfall, parties to leases similar to the one in *Top Line* may have an incentive to litigate. Increased litigation would cast doubt on existing commercial leases. Avoiding potential litigation could also add time and expense to the process of negotiating new leases.

17. Rhys Davies, "Was *Top Line* Wrongly Decided?" (2002) 60 Advocate 187.

18. R.S.B.C. 1996, c. 377.

19. *See* Davies, *supra* note 17 at 190. *See also* Victor Di Castri, *Registration of Title to Land*, vol. 1 (Toronto: Carswell, 1987 [looseleaf]) at § 148.

20. Joel Nitikman, "*Res Judicata* and Statutory Provisions: A Case Comment on *International Paper Industries Ltd.* v. *Top Line Industries Inc.* and a Cautionary Tale for Tax Practitioners" (1997) 55 Advocate 191.

21. *Ibid.* at 195.

22. *Top Line*, *supra* note 1 at para. 1.

23. *See* Hilliard, *supra* note 14 at 5.1.14.

IV. Developments Since the *Top Line* Case

There has been no legislative response to *Top Line*. All the developments since the case was decided have taken place in the courts. A number of decisions have considered *Top Line*. While no dominant position on the case has emerged, several trends can be summarized briefly.

The first point to note is that there has been an increase in litigation. Before *Top Line* was decided only three cases had considered the application of section 73 to leases.[24] The number of cases that consider section 73 since *Top Line* is more than triple this number.

The approach of these cases to *Top Line* has not been entirely consistent. A number of cases have simply applied the conclusion in *Top Line* that a document purporting to be a lease, which is in contravention of section 73, is void *ab initio*.[25]

In other cases, though, courts have tried to fashion remedies that limit the harsh effects of a finding of invalidity. A number of cases have fastened onto a comment in *Top Line*: "[i]t bears emphasizing that this result is without prejudice to any entitlement the Tenant may have to sue for whatever other remedies might be available to it on other branches of the law."[26] *R& R Ginseng Enterprises Ltd.* v. *Layton Bryson Outfitting and Trailriding Ltd.*,[27] for example, involved a document described as a lease and crop sharing agreement for an unsubdivided portion of the landlord's land. Pursuant to this agreement, the tenant had attempted to cultivate a crop of ginseng. The parties fell into a dispute before the crop was harvested. The court noted that this case was on point with *Top Line* and expressed some regret that simply declaring the lease and crop sharing agreement to be invalid ". . . may preclude the court from effecting substantial justice between the parties."[28] In the result, the court indicated that it would consider a claim for a constructive trust as an example of one of the "other remedies" allowed under *Top Line*.[29]

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24. *See supra* note 6.

25. *See Master Contract Services Ltd.* v. *Altamar Developments Corp.*, 2000 BCSC 644, Boyd J.; *Abbott Street Holdings Ltd.* v. *McFarlane*, (2000) 34 R.P.R. (3d) 33, 2000 BCSC 1067, Brenner C.J.

26. *Supra* note 1 at para. 41.

27. (1997) 10 R.P.R. (3d) 313 (B.C.S.C.), Grist J.

28. *Ibid.* at para. 17.

29. *Ibid.* at paras. 21–26. The state of the pleadings in the case did not allow the court to determine the claim for a constructive trust in the present application. For an example of another case exploring "other remedies" *see S.G.W.* v. *D.W.W.*, [1998] B.C.J. No. 840 (S.C.) (QL), Downs J. (court granting tenant remedies in trust, *quantum meruit*, and aggravated damages; court also granting tenant licence to occupy land until 30 days after monetary component of judgment satisfied).

Some cases have gone even further and considered whether *Top Line* was decided incorrectly. One case accepted the proposition that the failure to cite any provisions of the *Property Law Act* indicated that *Top Line* was decided *per incuriam* and thus is not binding.[30] This conclusion was sustained on appeal.[31] A later decision of the Supreme Court, though, has rejected the proposition that *Top Line* was decided *per incuriam*.[32]

Finally, the courts have not adopted a restrictive view of section 73 (3), which exempts leases of buildings or parts of buildings from the requirement of obtaining subdivision approval. In two cases *Top Line* was not applied because the lease at issue was classified as a lease of a building, even though the building had yet to be constructed.[33] One of these cases went slightly further and said that a patio (for a restaurant) may form part of a lease of a building for the purposes of section 73 (3).[34]

V. CONSULTATION

The Law Institute invites your comment on the issues raised in this Consultation Paper. In particular, we are interested in finding out whether those familiar with commercial leasing practices would support a law reform project that would consider legislative responses to the *Top Line* case.

There is a range of law reform options that may be considered in response to *Top Line*:

(1) An amendment to the *Land Title Act*. As noted above, early responses to *Top Line* did stress the need for legislative intervention. An example of one approach to amending the *Land Title Act*—the addition of a new subsection to section 73—is set out, for purposes of discussion, in the Appendix to this Consultation Paper.

(2) Leave the matter to the courts. As time has passed, it appears that the courts are attempting to develop remedies that blunt the harsh conclusion of *Top Line*. An argument could be made that this development should be allowed to continue, and should not be pre-empted by legislation.

30. *Russell* v. *Pfeiffer*, [1998] B.C.J. No. 973 (Prov. Ct.), de Villiers Prov. Ct. J.

31. *Pfeiffer* v. *Russell*, [1999] B.C.J. No. 2253 at para. 54 (S.C.) (QL), Drost J.

32. *BC Rail Ltd.* v. *Domtar Inc.*, (1999) 71 B.C.L.R. (3d) 242, 26 R.P.R. (3d) 308 (S.C.), Boyd J.

33. *456559 B.C. Ltd.* v. *Cactus Café Maple Ridge Ltd*, (2001) 93 B.C.L.R. (3d) 224, 44 R.P.R. (3d) 217, 2001 BCCA 622, Hollinrake J.A. (for the court) [*Cactus Café* cited to B.C.L.R.]; *Bowen Island Properties Ltd.* v. *Rogers*, (2003) 14 R.P.R. (4th) 259, 2003 BCSC 1595, Satanove J.

34. *Cactus Café*, *ibid.* at paras. 12–16.

(3) A third approach would be to consider *Top Line* in the context of a legislative response to illegal contracts generally. An example of general illegal contracts legislation is the *Uniform Illegal Contracts Act*, which was recently adopted by the Uniform Law Conference of Canada.[35]

The Law Institute is interested in receiving respondents' opinions on these three options for reform.

The Law Institute asks that comments be submitted by **31 January 2005**. Comments may be submitted in one of three ways—

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35. *See*, online: Uniform Law Conference of Canada <http://www.ulcc.ca/en/us/Uniform_Illegal_Contracts_Act_En.pdf>.

APPENDIX

Amendment to Section 73 of the Land Title Act—
Addition of New Subsection (7)
(for discussion purposes)

Restrictions on subdivision

73 (1) Except on compliance with this Part, a person must not subdivide land into smaller parcels than those of which the person is the owner for the purpose of

(a) transferring it, or

(b) leasing it, or agreeing to lease it for a life, or for a term exceeding 3 years.

(2) Except on compliance with this Part, a person must not subdivide land for the purpose of a mortgage or other dealing that may be registered under this Act as a charge if the estate, right or interest conferred on the transferee, mortgagee or other party would entitle the person in law or equity under any circumstances to demand or exercise the right to acquire or transfer the fee simple.

(3) Subsection (1) does not apply to a subdivision for the purpose of leasing a building or part of a building.

(4) A person must not grant an undivided fractional interest in a freehold estate in land or a right to purchase an undivided fractional interest in a freehold estate in land if the estate that is granted to or that may be purchased by the grantee is

(a) a fee simple estate on condition subsequent, or

(b) a determinable fee simple estate

that is or may be defeated, determined or otherwise cut short on the failure of the grantee to observe a condition or to perform an obligation relating to a right to occupy an area less than the entire parcel of the land.

(5) Subsection (4) does not apply to land if an indefeasible title to or a right to purchase an undivided fractional interest in

(a) a fee simple estate on condition subsequent in the land of the kind described in subsection (4), or

(b) a determinable fee simple estate in the land of the kind described in subsection (4)

was registered before May 30, 1994.

(6) An instrument executed by a person in contravention of this section does not confer on the party claiming under it a right to registration of the instrument or a part of it.

(7) A purported lease executed in contravention of this section is capable of taking effect as a licence for the purpose of creating personal rights and obligations among the parties to it.

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