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When are Late Payment of Rent Charges in Residential Tenancies Unenforceable?

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Case Commented On: *416566 Alberta Ltd. v Fothergill*, 2017 ABPC 96 (CanLII)

This Provincial Court decision by Judge Jerry LeGrandeur, Associate Chief Judge, is of interest because he considers whether the fee a landlord charged for the late payment of rent was a valid pre-estimate of liquidated damages or an illegal penalty. If it is an estimate of damages, the tenant must pay the fee. If it is a penalty, it is unenforceable and the tenant does not have to pay the fee. Judge LeGrandeur's decision was made under the *Mobile Home Sites Tenancies Act*, RSA 2000, c M-20, rather than the more often used *Residential Tenancies Act*, SA 2004, c R-17.1, but both statutes deal with late payment charges the same way: neither says anything at all about them. As a result, late payment fees can be included in leases and, if tenants agree to pay those fees by signing leases that include them, the tenants have to pay the late payment fees unless those fees are what the common law calls a "penalty." Judge LeGrandeur's decision, which is applicable to all types of residential tenancies, is welcome because there is a lack of direction in Alberta about how much can be charged for a late payment fee before it becomes an illegal penalty and unenforceable.

Some provinces have eliminated the common law devoted to distinguishing estimates of liquidated damages from penalties. They have done so by specifying maximum late fees. Some specify an amount. See, for example, section 7(1)(d) of the *Residential Tenancy Regulation*, BC Reg 477/2003, of British Columbia's *Residential Tenancy Act*, SBC 2002, c 78:

> **7** (1) A landlord may charge any of the following non-refundable fees:
> (d) subject to subsection (2), an administration fee of not more than $25 for the return of a tenant's cheque by a financial institution or for late payment of rent.

Others specify a percentage. In Nova Scotia, for example, the maximum is one per cent per month of the monthly rent; see Statutory Condition 9 in section 9(1) of the *Residential Tenancies Act*, RSNS 1989, c 401.

But in Alberta, the *Mobile Home Sites Tenancies Act* and the *Residential Tenancies Act* are silent on the topic of late payment fees (as they are on so many topics that other provinces' legislation deals with). In Alberta, the enforceability of late payment fees is left up to the common law.

Unfortunately, most of the easily available (i.e., online) advice that Alberta landlords and tenants can access simply states that late rent fees are allowed in lease agreements. At least some of the available forms of residential tenancy agreements suggest that landlords charge late rent fees but say nothing about how much or how to determine how much. See, for example, clause 12 of the

Alberta Residential Tenancy Agreement which states: "Rent is considered late the day after it is due. The landlord *may impose penalties* on a tenant for late rent payments" (emphasis added). That precedent is (surely) unintentionally ironic because "penalties" is exactly what the landlord *cannot* charge. Or see the second sentence of clause 3 of a different Alberta Residential Tenancy Agreement which provides: "Landlord may impose a late payment charge of _____ [Late Pay Charge] per day for any amount that is more than five (5) days late." The usual advice and forms are not very helpful to landlords wondering how much they can charge for late fees or tenants wondering if they have to pay late fees.

Our provincial government is more informative. Service Alberta warns residential tenants in its Quick Reference Guide that "[t]he *Residential Tenancies Act* (RTA) does not prohibit a landlord and a tenant from agreeing to non-refundable fees and charges that are in addition to the security deposit and rent" (whereas refundable ones are caught by the rules regulating security deposits). The Guide continues by stating that "once a tenant agrees to an additional fee or charge, the tenant is obligated to pay the fees or charges when the circumstances giving rise to them occur." This general and at least somewhat misleading advice is followed by a list of common non-refundable fees including "Late Payment of Rent or NSF Fees," about which the Guide vaguely warns:

> If the tenant does not pay the rent on time, the landlord may charge the tenant a late payment fee. However this fee or an NSF fee can only be charged if it is part of the tenancy agreement. These fees must be *reasonable, as landlords cannot impose penalties*. (emphasis added)

Service Alberta's brochure devoted to Residential Tenancy Agreements - Fees & Charges has more to say about "Late Payment of Rent Fees":

> Some residential tenancy agreements allow for a late payment of rent fee. The charge is usually a daily amount for each day the rent remains unpaid. *The courts or RTDRS do allow for an estimate of damages.* For example, a bank may charge additional interest if a landlord is unable to make a mortgage payment because the tenant did not pay the rent on time. *A late payment of rent fee that would cover the interest charged by the bank could be a valid estimate of liquidated damages, if they exist. If however, the late payment of rent fee is far more than the amount the landlord is being charged, then it may be found by a court to be a penalty – and penalties are illegal.* (emphasis added)

This is more accurate and helpful. There is a distinction drawn between a valid estimate of liquidated damages and illegal penalties, which is the distinction drawn in the common law. There is even an example of the former. However, illustrating what an illegal penalty is by describing it as a fee that is "far more than the amount the landlord is being charged" is not very helpful, even if it is the best that can be done. And, instead of merely hinting that the tenant does not have to pay it because it is illegal, the information could easily be improved upon by saying so.

The advice given by Student Legal Services of Edmonton, in their Landlord and Tenant Law, under "Tenant's Obligations" is much more helpful because of the language it is written in, the examples it gives, and its willingness to offer an example with dollar amounts (albeit while

omitting to mention that the example is taken from Judge LeGrandeur's opinion in *Cracknell v Jeffrey*, 2001 ABPC 11 (CanLII) at para 16):

> Many Tenancy Agreements include a Penalty Clause for late payment. These penalties are not covered in the RTA, but are found at common law. The rule, generally, is that a Penalty Clause is legitimate if it is a genuine pre-estimate of loss that a landlord will suffer as a result of late or non-payment of rent. This is determined by looking at the agreement as a whole. A penalty clause is not legitimate if it is does not bear any relation to the actual losses, but is merely a threat designed to frighten the tenant into timely payment of rent. Therefore, a penalty clause will not be legitimate where the sum is extravagant or excessively large compared to the possible losses, or if the tenant agrees to pay a certain sum of money and a larger sum if the first sum is not paid. For example, for a person paying $325/month, a late payment penalty of $5 per day late is not enforceable, since it is exorbitant compared to the rent (it would amount to almost 50% interest if you were one month late), and applies even if the tenant was short just $1.
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> Ultimately, whether or not a Penalty Clause is legitimate is up to the decision of a Judge. Your safest bet is to always pay rent on time. In situations where you cannot pay rent on time, or it is very difficult, it might be worth talking to your landlord to see if late payments will be accepted.

The need for cases about late payment fees that discuss the difference between valid pre-estimates of liquidated damages and illegal penalties in the context of residential tenancy rent payments is obvious. The more cases (i.e. examples) there are, the better a tenant or landlord or their lawyers could predict which category a court will assign any particular late payment fee to. There are, however, too few residential tenancy cases involving this issue. It is in this context that *416566 Alberta Ltd. v Fothergill* is a welcome addition to the sparse common law.

Now to the case itself.

The landlord, 416566 Alberta Ltd, wanted to terminate the tenancy of Robert Fothergill, which had begun in 2011, because the tenant had failed to pay rent or, in the alternative, had persistently paid rent late after April 1, 2016. The landlord claimed the arrears of rent were $1,050 for April 1, 2016 to April 15, 2017.

The tenant defended on the basis that late payment fees made up most of the alleged arrears, the late payment fees were not agreed to in the Mobile Home Site Tenancy Agreement, and the late payment fee was an illegal penalty and therefore not enforceable. He also argued that lateness in the payment of rent between April 1, 2016 and April 15, 2017 was not, in the circumstances, a substantial breach of the tenancy agreement.

The main issue was whether the late payment fees that the landlord charged the tenant were enforceable (at para 6).

Late payment fees were provided for in the rules of Mountain View Mobile Home Park. Those rules specified that rent was due and payable on the 1st day of every month and that a service charge of $40 would be added for rent received between the 2nd and 15th of the month

and a further service charge of $40 would be added for rent received after the 15th day of each month.

The landlord was unable to prove on a balance of probabilities that the tenant received notice of the fee for late payment of rent (i.e. a copy of the rules) as required by section 24 of the *Mobile Home Sites Tenancies Act*. For that reason alone, the late payment charge was unenforceable (at para 12).

Although it was not necessary for him to decide if the late payment fee was also unenforceable because it was an illegal penalty, Judge LeGrandeur did consider this question. He determined that the fee was indeed a penalty and therefore not enforceable against the tenant even if the tenant had received notice (at para 13).

Judge LeGrandeur took his summary of the law governing the issue of whether a late payment fee is a penalty or pre-estimated damages from his own decision in *Cracknell v Jeffrey*, 2001 ABPC 11 (CanLII) (holding a late payment fee of $5.00 per day after the first of the month to be exorbitant and clearly a penalty) at paras 14-15:

> The question to be asked with regard to this claim is whether it is a genuine pre-estimate of damage, occasioned by the late payment of rental and suffered by the landlord, or whether it is a threat held over the Defendant *in terrorem*. (*Calgary v. Janese-Mitchell Const. Co.*, (1919) 59 SCR 101). If it is the former, it may be enforceable, if it is the latter, it is considered a penalty and likely not enforceable. In the case *Dunlop Pneumatic Tire Co. v. New Garage and Motor Co*., [1915] A.C. 79 at 86, Lord Dunedin laid down some general rules for the court's guidance in determining whether the matter is a genuine pre-estimate of damage or a penalty. These principles were culled from other decisions and have been accepted by Courts in Canada and are still accepted by Courts in Canada:
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> > (1) The sum in question will be a penalty if it is extravagant and unconscionable in amount in comparison with the greatest loss that could possibly follow from the breach.
> > (2) If the obligation of the promisor is to pay a certain sum of money and it is agreed that if he fails to do so he will pay a larger sum, this larger sum is a penalty.
> > (3) If there is only one event on which the sum agreed is to be paid, the sum is liquidated damages.
> > (4) If a single lump sum is made payable upon the occurrence of one or more or all of several events, some of which may occasion serious and others only trifling damage, there is a presumption, but no more, that the sum is a penalty. But not necessarily if it is difficult to prove actual loss.
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> Whether the sum claimed is a penalty or a genuine pre-estimate of damage is a question of law to be decided upon consideration of the whole agreement. (*Reimer v. Rosen*, [1919] 1 WWR 429, Man. C.A.) Although the parties to a contract may always try to make a pre-determination as to damages, should the contract be breached, this must always yield to judicial approval of its reasonableness in the circumstances. (See: *H.F. Clarke Ltd. v. Thermidaire Corporation Ltd*., (1975) 54 DLR (3d) 385 per Laskin, CJC at

> 393) That approach is consistent with the principle that an injured party is entitled to be compensated and made whole, but not bettered by a damage award. (See: *Neunier v. Cloutier*, (1984) 9 DLR (4th) 986)

Applying that law to the facts in the case before him, Judge LeGrandeur noted there was no evidence to suggest the $40 charges were a genuine pre-estimate of damage. Given that $40 was payable whether payment was one or fifteen days late, he held that it could not be seen as a genuine pre-estimate of damage (at para 15). However, he hypothesized that if the charge was $40 if the rent was fifteen days late and $80 if the rent was thirty days late, it would be arguable that it was a reasonable pre-estimate of damages and not excessive or extravagant (at para 15). Judge LeGrandeur was clear it was the fact that the late payment fee was $40 whether it was one, two or fifteen days late, and $80 whether it was sixteen, seventeen or thirty days late, that made the charge "a threat and punitive response to late payment regardless of how long the lateness is" (at para 15).

A word of caution must be said about relying on *Dunlop Pneumatic*. Judge LeGrandeur relied upon his 2001 summary of the law in *Cracknell v Jeffrey*, and that summary relied upon the 1915 *Dunlop Pneumatic*, which was accepted by Canadian courts sixteen years ago as a correct statement of the law. However, it would have been good to note that in 2015 the UK Supreme Court changed the long-established test for identifying a penalty clause in *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis*, [2015] EWSC 67. It shifted the test away from a focus on "genuine pre-estimate of loss." Now, when considering whether a clause is a penalty, it is not just the financial loss that would have been suffered as a result of the breach that is relevant, but also whether others in the same industry impose similar charges, the indirect business cost to the innocent party of breaches, and whether the obligation triggered by the breach was brought to the defaulting party's attention.

This change in the UK law on the topic does not mean that Canadian law has changed or will change. And it certainly does not mean that Judge LeGrandeur's conclusions are wrong. For one thing, he held that the late payment fee was not proven to have been properly brought to the tenant's attention, which was conclusive under the *Mobile Home Sites Tenancy Act* and relevant under the new UK test. For another thing, the change in the UK law might be confined to contracts between commercial parties on an equal footing — a context emphasized by the UK Supreme Court — and not apply to parties with a well-recognized power imbalance (noted by Judge LeGrandeur at para 22). The reception of *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis* in Canada might depend upon whether there is a trend here to be more reluctant to interfere with parties' freedom of contract. The Supreme Court of Canada has already recognized that the traditional law on penalty clauses is "a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum" (*J.G. Collins Insurance Agencies Ltd v Elsley Estate*, 1978 CanLII 7 (SCC), [1978] 2 SCR 916 at para 47).

There was one more problem standing in the tenant's way in this case. The rent due for April 1, 2016 to April 15, 2017 — minus the late payment fees — was $3,940. The tenant had paid $3,930, or only $10 less. Judge LeGrandeur conceded that a literal reading of sections 19, 25 and 32 of the *Mobile Home Sites Tenancies Act* suggested that the failure to pay any amount of rent was a "substantial breach," as that term was defined in the *Act*, and therefore a reason to terminate the tenancy.

Judge LeGrandeur refused to read the *Act* literally, however, and instead read it to say that rent arrears justifying termination of a tenancy had to be "substantial in fact, not just in name" (at para 26). He held that the literal interpretation would frustrate or defeat the purposes of the legislation (at para 27) and be absurd and inconsistent with the spirit of the *Act* (at para 26). As Judge LeGrandeur also noted, both the *Mobile Home Sites Tenancies Act* and the *Residential Tenancies Act* were aimed at addressing the imbalance of bargaining power between the landlord and the tenant that existed at common law and under previous legislation (at para 22). He also mentioned the substantial financial and social consequences that might follow from a termination of a mobile home tenancy, referencing the history of mobile home site tenancy legislation set out in the *Tenancies of Mobile Home Sites*, Report #28, Institute of Law Research and Reform, April 1978 (at para 23). As a result, Judge LeGrandeur refused to terminate the tenancy.

Judge LeGrandeur's willingness to take the time to write a decision about the enforceability of late payment fees in the residential tenancy context should be commended. It is much easier to make these decisions orally and simply resolve the particular dispute between the particular parties by doing so, without creating a precedent. However, when a legal question is governed by the common law, as the issue in this case was, it is necessary to provide those who find themselves in similar circumstances (often self-represented in this context) with examples of how the law works in practice. The more examples, the easier it is to find out what the law is and the more certain and predictable the law is. Written decisions are a contribution to access to justice.

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