



Fall 2016

TOPICS:

**Recent Developments
of Importance in Property
Leasing: Part II**

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**RECENT
Developments
of Importance in
PROPERTY
LEASING:
PART II**

QUIET ENJOYMENT:

**A Functional
Landlord Covenant or a
Theoretical Concept with
No Remedy for Tenants?**

The right of a tenant to enjoy its premises without interference from its landlord is unquestionably essential to any lease. At the time of entering into a lease, it is hard to anticipate and capture all of the instances that constitute interference. Furthermore, landlords often specify that interference as a result of repairs and improvements



to the property or premises will not constitute a landlord default. So where is the line drawn? To what extent does a tenant have to suffer — and in whose opinion — for it to be entitled to some form of remedy? These next two cases indicate that the burden of proof is high, loss of profits may not be enough, and a minor interference (even if major to a tenant) will not garner a favourable finding from the court.

In 37504 *Yukon Inc. (Sam n' Andy's) v. 46249 Yukon Inc.*, the restaurant Tenant brought a claim for damages and expenses for breach of its right to quiet enjoyment after it was forced to close its restaurant for 1.5 days while the Landlord replaced a sewer pipe.

The Yukon Territory Small Claims Court explained that a tenant must show that the landlord substantially interfered with its enjoyment of the premises in order to recover damages. While the restaurant was closed for a relatively short time, the Tenant suffered serious business losses, which amounted to serious and substantial interference with the Tenant's enjoyment of the Premises. However, the closure was not caused by an act or omission of the Landlord, as the sewage pipe did not have a history of backing up and there was no indication that the pipe would fail. Furthermore, the Landlord had the pipe repaired in a timely fashion. The Court held that the Tenant's claims for breach of quiet enjoyment and breach of contract could not be sustained; however, the Tenant was entitled to rent abatement in accordance with the Lease and reimbursement for some labour and cleaning supplies.

The case of *Stearman v. Powers (c.o.b. Walkabout Casual Wear)* is an update from the Superior Court decision we included in our *Summer 2015 Newsletter*. As a reminder, this case considered whether a pervasive and unpleasant odour coming from the building's HVAC system breached the Tenant's right to quiet enjoyment and the implied term of fitness in the Premises. The Superior Court dismissed the Landlord's

claim for non-payment of rent on the basis that the odour breached the covenant of quiet enjoyment and substantially deprived the Tenant of the whole benefit of the Lease and allowed the Tenant to terminate.

The British Columbia Court of Appeal reversed the decision and held that the odour was not a breach of the covenant of quiet enjoyment. The Court explained that quiet enjoyment refers to the tenant's right to exclusive occupancy and enjoyment of the premises without substantial interference by the landlord. The odour was not grave or permanent in nature and there was no evidence that it was the result of the Landlord's act or omission. Furthermore, the Lease expressly provided that the Tenant was leasing the Premises on an "as is" basis.

The Court of Appeal also found that the odour was not a fundamental breach of the Lease; where the breach goes to the root of the contract and substantially deprives a tenant of the benefit of the lease. Despite the presence of the odour, the Tenant was able to carry on her clothing business and was not able to prove loss of profits.

The case of *Bachechi Bros. Realty Inc. v. Canwest Marine Services Inc.* followed the Court of Appeal's decision in *Stearman*. In *Bachechi*, the Landlord brought an application for an injunction to restrain the Tenant from misusing a parking lot. The Tenant counterclaimed and sought damages for the Landlord's breach of the covenant of quiet enjoyment on account of the Landlord's unannounced visits to the Premises to monitor the parking lot. The Court referred to *Stearman* and noted that the law concerning the covenant of quiet enjoyment is well-settled and a tenant must demonstrate that the landlord's actions have rendered the premises "substantially less fit for the purposes for which they were let." The Court rejected the Tenant's claim, as there was no evidence that the visits substantially interfered with or prevented the Tenant's day-to-day business operations.

RIGHT OF FIRST REFUSAL: **How Fast do Tenants have to Act?**

A Right of First Refusal (ROFR) is a strategic consideration that is advantageous to both landlords and tenants. Generally, a tenant's ROFR to lease other space in a building will be triggered when the landlord subsequently receives an offer to lease the same space.

In *Lenco Investments Inc. v. 1440825 Ontario Inc.*, the Lease contained a typical ROFR, wherein the Landlord had to notify the Tenant of any third-party offer to purchase the property and the Tenant had 30 days to decide whether or not to match the offer. The ROFR was subject to termination if either party terminated the Lease on three months' notice as provided thereunder. When the Landlord received and accepted a third party offer to purchase the property and terminated the Lease, the Tenant purported to exercise the ROFR.

The Landlord applied for judicial interpretation of the ROFR. The Ontario Superior Court found that the Landlord was allowed to terminate the tenancy in accordance with the mechanism provided under the Lease and thus, the tenant could no longer exercise the ROFR.

The Ontario Court of Appeal reversed the decision and emphasized the importance of interpreting the ROFR and the termination right in the context of the Lease as a whole. When the Landlord received the third party's offer to purchase the property, it was obligated to notify the Tenant and was only entitled to terminate after the Tenant had an opportunity to match the offer and declined to do so. Otherwise, the ROFR would be a meaningless right for the Tenant. The Court of Appeal held that the Tenant had properly exercised the ROFR and ordered the Landlord to enter an agreement of purchase and sale with the Tenant.

TERMINATION RIGHTS: **When Does a Legitimate Business Term Become a Misuse of Power?**

Termination rights are perhaps the most extreme rights in a commercial lease. Both landlords and tenants devote a great deal of time contemplating these rights during lease negotiations. Given the thought (and drastic consequences) involved in granting termination rights, parties purporting to invoke such rights should assume that they'll be held to the highest standard in their exercise thereof and that their rights will be interpreted with the strictest construction.

In *2249740 Ontario Inc. v. Morguard Elgin Ltd.*, the Plaintiff Tenant entered into a Lease for a historic building in Ottawa. The initial Lease Term was 10 years with two five-year options to renew. The Landlord wanted the building occupied by the Tenant even though the Landlord would eventually require vacant possession so it could build a development on the adjacent lot. The development could not begin until the Landlord secured an anchor tenant.

The Lease contained a delayed possession clause that allowed the Landlord to terminate the Lease if it reasonably believed that it would not be able to deliver possession within six months of the commencement date. After the Lease was executed, the parties agreed that the possession date would be delayed by one year if the Landlord could not secure an anchor tenant or three years if the Landlord could secure an anchor tenant. The Landlord secured an anchor tenant, but was unable to successfully negotiate further amendments to the Lease, so the Landlord relied on the delayed possession clause and terminated the Lease. The Tenant sued for wrongful termination of the Lease and brought a motion for summary judgment.

The Ontario Superior Court held that the Landlord's reliance on the delayed possession

clause was unreasonable and that the Lease was wrongfully terminated, as the Landlord had secured an anchor tenant, therefore the commencement date had been extended by three years. The Landlord could not have reasonably known so far in advance at the time it terminated that it would not be able to deliver possession within six months of the commencement date. Further, the Landlord admitted that the termination of the Lease was an inevitable consequence of proceeding with the development. The Landlord essentially made a business decision to terminate the Lease and its reliance on the delayed possession clause was not a legitimate exercise of its rights.

USE OF PREMISES: **Where is the Line Drawn between Permitted and Prohibited Use?**

Three recent cases from across Canada remind us of the far-reaching impact that a Use clause has on a tenant's ability to operate its business. The case of *0764673 B.C. Ltd. v. Amacon Dawson Development Partnership* illustrates that a tenant who uses its premises for a purpose wholly inconsistent with the terms of a lease — and such a contravening use imposes a considerable risk to a landlord — cannot expect a court to fault a landlord for not expressly carving out certain restrictions.

On the other hand, the Ontario Court of Appeal decision in *2249778 Ontario Inc. v. Smith* signals the court's unwillingness to step in and imagine what uses might be prohibited under a lease when the parties have a clear opportunity to contemplate and draft the parameters of use before the lease is signed. With both *0764673 B.C. Ltd.* and *2249778 Ontario Inc.* in mind, landlords who wish to limit uses that are naturally or logically ancillary to a primary use should draft accordingly in order to avoid a court's expansive interpretation of a permitted use.



The case of *Corydon Village Mall Ltd. v. Tel Management Inc.*, deals with a tenant's requested change in use and a landlord's limited obligation to provide its consent in the face of other tenants' exclusive use rights and the general character and retail mix of a shopping centre. However, while a landlord's obligation might be limited, a tenant's inability to carry out its permitted use due to financial constraints is certainly an area of concern for both landlords and tenants.

In *0764673 B.C. Ltd.*, the Lease provided that the Tenant's Use of the Premises was for the purpose of a light industry masonry warehouse and business headquarters. During an inspection, the Landlord found a licensed marijuana grow operation in the Premises. The Lease did not provide for a cure period and the Landlord terminated on the basis that the grow operation was not a permitted use. The Tenant removed the marijuana plants and sought a declaration that the termination was invalid, or alternatively, it should be granted relief from forfeiture.

The British Columbia Supreme Court held that the grow operation constituted a violation of the Use clause and the Landlord was entitled to terminate the Lease. The Tenant was not entitled to relief from forfeiture because it entered the Lease with no intention of complying with the Use. Further, the Tenant knowingly put the Landlord at risk of suffering extensive losses. The Court noted that the Tenant's conduct had irrevocably destroyed the normal landlord-tenant business relationship contemplated by the Lease. Furthermore, the fact that the grow operation was removed from the Premises did not mean there was no longer any breach of the Lease to support termination, as the Lease had already been properly terminated.

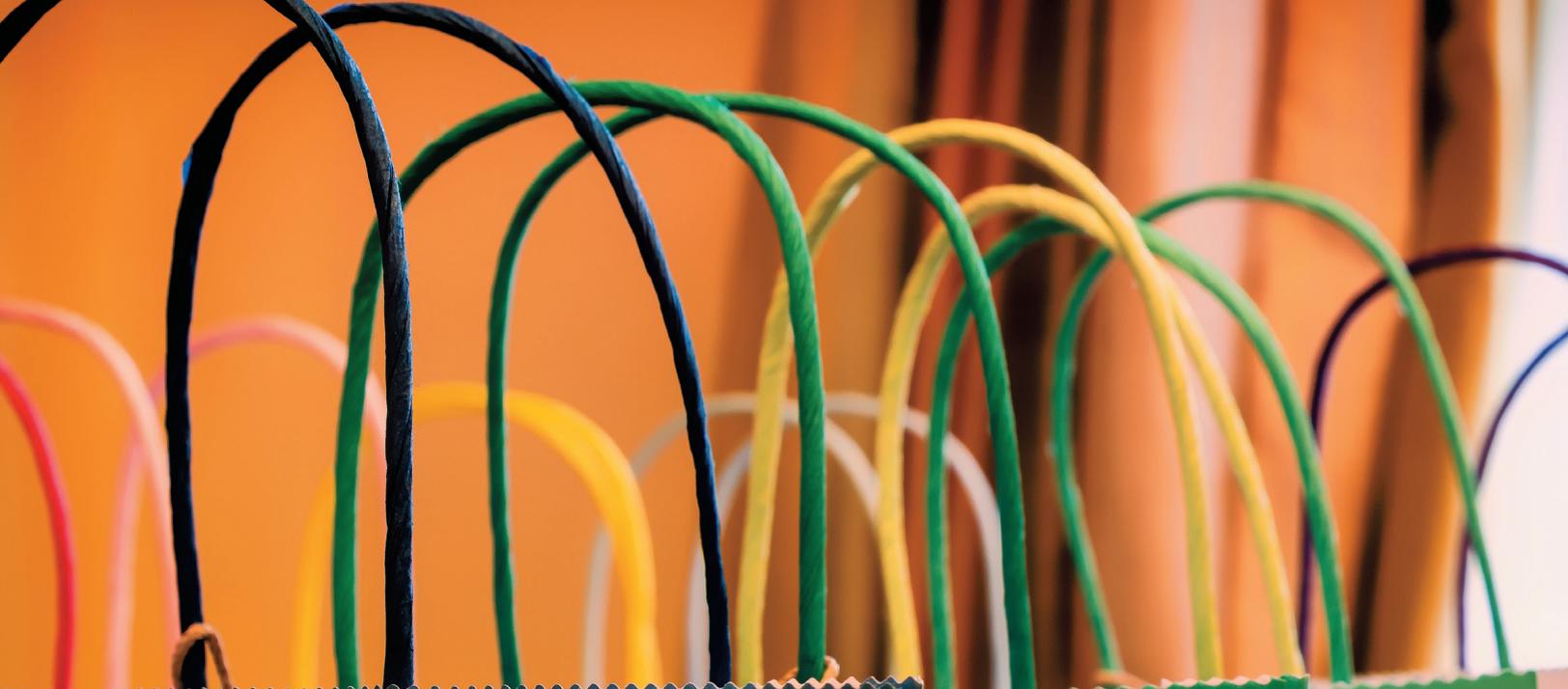
In *2249778 Ontario Inc.*, the Lease specifically provided that the Premises was to be used for the operation of a fast food restaurant and "for no other purpose." After signing the Lease, the Tenant immediately installed an ATM in the Premises. The Landlord sought a declaration that the ATM was not a permitted use of the Premises and brought an order requiring the ATM's removal.

The Ontario Superior Court held that the ATM was a permitted use under the Lease because it did not alter the purpose of the Premises. The ATM was merely a tool that the Tenant used to achieve its business objective of running a fast food restaurant and did not signify (as the Landlord suggested) that the Tenant was offering banking services.

The Landlord unsuccessfully appealed the Superior Court's decision. The Court of Appeal found that the Lease did not specifically prohibit the installation and operation of an ATM in the Premises nor did it define "fast-food restaurant". The Court of Appeal noted that "it is open to parties to a commercial lease" to specifically prohibit the installation and operation of an ATM in the Premises.

In *Corydon Village Mall Ltd.*, the Tenant leased space in the Landlord's shopping centre for the retail sale of women's shoes and related accessories and "for no other purpose whatsoever." Within months of signing the Lease, the Tenant experienced financial difficulties that it attempted to resolve by changing its business. The Landlord refused to permit the proposed amended use because it violated existing exclusive use rights granted to other stores. The Landlord also rejected the Tenant's subsequent request to sublet the Premises to a pole dancing school. The Tenant eventually abandoned the Premises and the Landlord brought a claim for damages.

The Manitoba Court of Queen's Bench held that the Landlord had not unreasonably withheld its consent with respect to the Tenant's proposed amended use and the proposed sublease. The Court found that the Tenant's requested change in business to sell seasonal giftware and clothing was prohibited under the Lease and the Tenant was not entitled to reasonable consent. Further, the Landlord was entitled to reject the Tenant's request to sublease. The Landlord gave proper consideration to the Tenant's proposal and its decision was objectively reasonable given that: (1) the proposed subtenant's use would not fit in with the family-oriented character of the shopping mall, (2) the proposed subtenant desired



“
The Landlord refused to permit the proposed amended use because it violated existing exclusive use rights granted to other stores.
”

to operate outside of normal business hours, and (3) the Landlord had previously declined to enter into a lease directly with the proposed subtenant. The Landlord was awarded the full amount of rent owing under the lease plus interest.

OPTIONS TO RENEW:

On Which Terms and on Whose Form is a Renewal Term Formalized

The following two cases represent typical disputes that often arise out of uncertain renewal or extension lease provisions that leave decision making to a future time. Both *1251614 Ontario Ltd. v. Gurudutt Inc.* and *1323677 Alberta Ltd. v. 334154 Alberta Ltd.* involve a party taking issue

with generally-accepted leasing practices and illustrate the lengths that a dissatisfied party will go to in order to undo an unfavourable (though agreed upon!) lease provision. Furthermore, both cases underscore the importance of including a mechanism for dispute resolution in the lease to avoid spending time and money on litigation in situations where the nature of the dispute lends itself to determination by binding arbitration.

1251614 Ontario Ltd. highlights the need for assignees to pay careful attention to special provisions when taking over a lease. In this case, the Original Tenant signed a Lease with an initial Term of 10 years plus two options to renew on the same terms and conditions as contained in the original lease, except the form of the renewal would be — at the Landlord’s option — either an extension agreement or a brand new lease on the

Landlord's then current standard form. During the initial Term, the Original Tenant transferred the Lease to the Plaintiff Tenant with the Landlord's consent.

The Plaintiff Tenant exercised its option to renew before the expiry of the initial Term and the Landlord provided its current standard form of lease, which was substantially similar to the existing Lease except that the current form contained a demolition clause. The Plaintiff Tenant refused to sign the current form, arguing that it had the right to renew the lease on the same terms and conditions as the existing Lease. The Landlord applied for an order to have the Plaintiff Tenant execute the current standard form as a precondition of exercising its renewal right.

The Ontario Superior Court held that the Plaintiff Tenant was obligated to sign the current standard form if it wished to renew. The Court emphasized that both parties were sophisticated business entities and counsel had reviewed the Lease before it was assigned without any objections. At the same time, the Court noted that the Landlord's right to use its current form meant that the new form could include material changes; otherwise, the right would have been meaningless.

A note to tenants: landlords include these types of renewal clauses in order to preserve their flexibility and control over future development opportunities and to ensure that their standard form lease can evolve over time. Tenants should always attempt to strike a landlord's right to require a tenant to enter into a new lease — there can never be certainty as to what a tenant may be compelled to agree to if it wants the benefit of the special rights (in this case, lease renewal) it bargained for at the outset.

The case of *1323677 Alberta Ltd.* deals with the uncertainty of renewal rents when the lease provides for fair market rents. When the Tenant served notice of its intention to exercise an option to renew the Lease, the Landlord responded with an offer to enter into a new lease. The Tenant rejected the offer and the Landlord demanded that the Tenant vacate the Premises on the grounds that the renewal option was void for uncertainty

since it failed to deal with future rents. The Tenant brought various applications against the Landlord for declaratory relief.

The Alberta Court of Queen's Bench considered whether the option to renew was enforceable. The renewal clause provided that the rent payable would be equal to "such amount of rent as shall be agreed between the parties based on market value and failing agreement shall be decided by arbitration." The Landlord argued that the renewal clause was void for uncertainty and relied on prior case law, which held that an option to renew may be void for uncertainty where the renewal rent will be agreed upon later.

The Court held that the renewal clause in question was enforceable because the amount of future rents was ascertainable with reasonable certainty. When the renewal clause was read contextually with the whole of the lease, the clause provided the formula and machinery to calculate future rents. Further, the fact that the Lease had been previously renewed suggested that the renewal clause contained in the existing Lease posed no difficulty for determining future rents.

DUTY OF HONEST PERFORMANCE:

A Much-Needed Evolution of Canada's Common Law or an Onerous Standard?

While Canadian courts have previously been reluctant to find a stand-alone duty of good faith, the unanimous Supreme Court of Canada decision in *Bhasin v. Hrynew* clearly established a new duty of honest and good faith contractual performance. This landmark case marked the first time the SCC considered whether parties to a contract owe each other a duty of good faith in performing their contractual obligations.

When we included this case in our *Summer 2015 Newsletter*, it had yet to be seen how *Bhasin*

would go on to shape business relationships and contractual performance. A decision of this magnitude was likely to pose more questions than answers in the short-term and commercial parties were advised to govern themselves accordingly in light of the fact that good faith and honesty were now part of the law.

As a reminder, this decision took “two incremental steps” to advance the common law of contracts in Canada: (1) the Court explored “good faith” as an organizing principle that manifests itself through existing legal doctrines, and (2) the Court characterized the “duty of honesty” as a general doctrine of contract law that applies to all contracts and cannot be excluded by an “entire agreement” clause. However, the new duty of honesty from *Bhasin* does not go so far as to impose a duty of loyalty or of disclosure. Furthermore, *Bhasin* only applies in the context of performing contractual obligations and not in negotiating these obligations.

Since the release of *Bhasin*, subsequent judicial decisions have shed some light on its meaning. The British Columbia Supreme Court in *Burquitlam Care Society v. Fraser Health Authority* aptly described *Bhasin* as an authority for the principle that parties to a contract “must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.”

As with any major decision, the legal community was concerned with how far courts

would go to interpret contracts in order to give effect to the *Bhasin* decision. In *Moulton Contracting Ltd. v. British Columbia*, the British Columbia Court of Appeal clarified that *Bhasin* does not suggest that the two tests for implying terms at law and implying terms for business efficacy should be combined to reach a “hybrid law-fact conclusion on whether to imply terms.”

The Alberta Court of Appeal in *Scott & Associates Engineering Ltd. v. Finavera Renewables Inc.* considered the *Bhasin* requirement that one contracting party have appropriate regard to the legitimate interests of the other contracting party. The Court in *Scott & Associates* held that “appropriate regard” does not require a party to serve those legitimate interests in all cases, but does require that the party not seek to undermine those interests.

Nearly 20 years after the Supreme Court of Canada in *Wallace v. United Grain Growers Ltd.* held that “good faith” may be “incapable of precise definition,” a consistent definition for “good faith” is notably missing from Canadian common law. Accordingly, the practicality of “good faith” as a guiding principle continues to be questioned and the implication of *Bhasin* in this regard still remains to be seen.

Special acknowledgment and thanks to Carrington Hickey, Student-at-Law, for her assistance in preparing this article. Re-printed in part from The 2016 Canadian Legal Lexpert Directory.



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In Memoriam

David Louis (1948-2016) - It is with great sadness that we announce the passing of our longtime colleague and friend, David Louis. David was the former Chair of our Tax Group, with over 30 years in tax law working closely with clients and mentoring colleagues. He was well-respected across the country for his knowledge and prolific writing on all things tax-related. He will be remembered for his wit, his devotion to his family, and his love of wind surfing and music. He will be deeply missed.

Firm News

We are pleased to announce that **Brian Temins** was elected to the firm Executive Committee.

Minden Gross LLP welcomes **Steven Birken** to the firm to practice in our Commercial Leasing Group, **Lauren Lee** who joins our Bankruptcy and Insolvency Group, and **Danna Fichtenbaum** who practices estate litigation as part of our Wills and Estates Group. Welcome back to **Carrington Hickey**, who joins us as an Associate in our Employment and Labour Group. Carrington articulated with Minden Gross LLP from 2015 to 2016.



Steven Birken



Lauren Lee



**Danna
Fichtenbaum**



**Carrington
Hickey**

Professional Notes

Minden Gross LLP is pleased to announce that **Howard Black** (Trusts and Estates); **Andrew Elbaz** (Mining Law); **Michael Horowitz**, **Stephen Messinger**, **Adam Perzow**, and **Stephen Posen** (Commercial Leasing); and **Reuben Rosenblatt**, QC, LSM (Real Estate), have been recognized by their peers in the 2016 edition of *The Best Lawyers in Canada*.

The **Commercial Leasing Group** participated in the ICSC Canadian Convention on September 20-21, where **Stephen Messinger** was on the Program Planning Committee. They also attended the 2016 Real Estate Strategy & Leasing Conference where **Stephen Posen** moderated a panel on "Tenant and Landlord Rights and Remedies" and Stephen Messinger moderated a panel on "Negotiation Strategies for Today's Market" on October 6. The two were also listed in the *Lexpert Special Edition on Infrastructure*.

Benjamin Bloom was quoted in "A man is selling Hackintoshes for \$329, and he really hopes Apple won't mind" in the September 2 edition of *Digital Trends*.

Minden Gross LLP acted for Mackie Research Capital Corporation in connection with the best efforts short-form prospectus offering of Eguana Technologies Inc. (TSXV: EGT) with a team that included **Andrew Elbaz**, **Sasha Toten**, and **Joan Jung**.

The Tax Group, including **Joan Jung**, **Michael Goldberg**, **Samantha Prasad**, **Matthew Getzler**, and **Ryan Chua**, presented a Wolters Kluwer webinar on "Income Splitting – Opportunities and Pitfalls" on October 11.

Joan Jung presented at the LSUC program "Taxation for General Practitioners" on the topic of "New Developments in the Taxation of *Inter Vivos* and Testamentary Trusts" held on September 16.

Michael Goldberg co-presented "Goodwill and Other ECP: Goodbuy (and Sell) - Your Last Chance" at the CIDEL Provence Conference in France on September 15 and hosted the first session of *Tax Talk: Year 4* on September 14. He was quoted in the article "Changes could prove taxing to businesses" in the September 2016 *The Bottom Line* and published "Sell Now! (How the 2016 Budget will Impact Business Owners' Exit Strategies)" in the August 2016 *Small Business Times*. He presented to TD Bank advisors on July 27 on key changes from the 2016 Federal Budget that affect owner/managers and published "NRT Tax Traps and the Non-Specialist Advisor - Part 4" in the July 2016 *Tax Notes*.

Samantha Prasad was a panelist at the Every Family's Business event with RBC and Richter on September 28. She published two articles on *The Fund Library* including "Succession planning using an estate freeze" on August 25 and three articles in *The TaxLetter* including August's "Wind-up of a Family Trust"

Matt Maurer published four new articles on *Slaw.ca*, including "Buyer Tries Everything to Avoid Paying Commission to Agent" on June 28. He published two articles in *REM Online* including "More abuse of our justice system by tenants" on July 22. On July 15 he appeared on *CTV News at Six* and *CBC Toronto News* where he commented on a recent judgment.

Catherine Francis published "Competing priorities under the model receivership order: *RBC v. Galmar*" in *Rebuilding Success*, Fall/Winter 2016 edition.

Hartley Nathan and **Ira Stuchberry** presented the webinar "Corporate Governance Essentials" to North American Meritas affiliate members on August 17. Ira was also named as Assistant Editor of *The Directors Manual*.



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Irvin Schein published three articles at irvinschein.com including "You Have Breached a Contract: Can an Exclusion Clause Protect You from a Damage Claim?" on July 29. He also published "Whose House is it Anyway? The Latest on Resulting Trusts" in *Canadian Family Law Matters'* August 2016 issue.

Arnie Herschorn co-presented to claims examiners at LawPro "Damages in Real Estate Transactions" with Peter Macaulay of P. Macaulay & Associates Inc. on September 15.

Eric Hoffstein spoke on estate planning at the Canadian Association of Gift Planners (CAGP) Leave a Legacy Information Series on September 14. On October 29, he led a workshop on Will Challenges at the CBA National Will, Estate & Trust Fundamentals program.

Reuben Rosenblatt spoke on "Scary Cases on Communication" at the OBA's Scary Communication Issues for the Real Estate Practitioner program held on October 27. We also congratulate Reuben on his 40th year as an Adjunct Professor at Osgoode Hall Law School teaching the Real Estate Transactions Course.

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