Current Issues and Trends in Commercial Leasing

Brian Parker, Partner

Daoust Vukovich LLP

This paper accompanies a presentation of the same name given by Brian Parker on November 19, 2024, at the *Eight-Minute Real Estate Lawyer 2024*, hosted by the Law Society of Ontario. It is intended to offer real estate lawyers with insight into current legal issues and trends in commercial leasing. It is composed of four sections: (1) a landlord's duty to mitigate; (2) the scope of the six-year limitation period under the *Real Property Limitations Act*; (3) the impact of changes to the *Competition Act* on exclusive use clauses and restrictive covenants; and (4) a brief summary of market and negotiation trends. Citations to cases and legislation referred to in this paper are set out in Appendix I hereto.

1. LANDLORD'S DUTY TO MITIGATE

Recently, tenants have been testing the Court's resilience in affirming that a landlord is not required to mitigate its loss before the lease is terminated, and that it can respond to a tenant default by "doing nothing" and simply insisting on the ongoing payment of rent.

In *Daniels CCW Corporation v. Shevchuk*, the tenant repeatedly failed to pay rent. Nine months after the initial failure, the landlord issued a notice of default. The landlord did so again four months after that. The tenant advised the landlord that the tenant's business would not survive the impact of the COVID-19 pandemic, and that the landlord should simply terminate the lease. The landlord decided not to terminate the lease at that time. A few months later, the landlord delivered another notice of default. This time, when the tenant failed to cure the default, the landlord terminated the lease. In the notice of default relied on to terminate the lease, the landlord reserved the right to claim damages against the tenant for the lost future rent. The termination of the lease occurred nearly 16 months after the tenant's initial non-payment.

After termination, the landlord took steps to re-rent the premises. Eventually, the landlord entered into an agreement to lease the premises at rents greater than those payable under the original lease. Approximately 18 months elapsed from the date of termination of the original lease to the commencement of the new lease. The landlord sued the tenant for the arrears and

the lost future rent, crediting against the lost future rent the amount of the increased rents under the replacement lease.

The tenant did not dispute that it owed the landlord some amount in respect of arrears of rent up to the date of termination, but argued that by waiting to terminate the lease for 16 months, the landlord failed to make reasonable efforts to mitigate its losses.

The Court restated the various remedies available to a landlord when a tenant is in fundamental breach or has repudiated the lease, as set out by the Supreme Court of Canada in *Highway Properties Ltd v Kelly, Douglas* ("***Highway Properties***"), being: (1) do nothing and insist on performance on the basis that the lease remains in force; (2) terminate the lease, retaining the right to sue for arrears to the date of termination; (3) re-enter the premises and attempt to sublease the premises on behalf of the defaulting tenant; or (4) terminate the lease and pursue a claim against the tenant for arrears of rent and "damages" in the form of rent payable over what would have been the balance of the term.

The Court noted that Canadian caselaw has consistently held that a landlord's choices are mutually exclusive and there is no duty to mitigate if a landlord chooses to keep the lease alive. In making this determination, the Court followed well-settled law, including *Anthem Crestpoint Tillicum Holdings Ltd v Hudson's Bay Company ULC*, a more recent British Columbia Court of Appeal decision, which tested *Highway Properties*.

In *The Canada Life Assurance Company et al. v Aphria Inc*, the tenant leased commercial office space in Toronto under a 10-year lease. A few years later, the tenant's business had changed course and the office space no longer fit into its business plans. The tenant advised the landlord that it no longer required the premises and proposed an early termination. The landlord rejected the tenant's proposal. The tenant then claimed to repudiate the lease and paid the landlord an additional three months' rent. The landlord notified the tenant that it rejected the tenant's purported unilateral repudiation, and that it was electing to keep the lease alive. The tenant's broker provided the landlord with leads for new potential tenants. The landlord did not follow-up on the leads. When the tenant ultimately stopped paying rent, the landlord sued the tenant.

The tenant challenged the idea that the landlord can "do nothing" and asked the Ontario Superior Court of Justice to impose a duty to mitigate, regardless of the remedy selected by the landlord.

The landlord pointed to 50 years of jurisprudence based on *Highway Properties*, confirming that it had no duty to mitigate so long as the lease is not terminated. The tenant argued that the time had come to overrule those decisions, characterizing them as an "anomaly in contract law". The tenant argued that "in all other areas of commercial contract law, an innocent party to a repudiation is expected to take reasonable steps to mitigate or to avoid the losses associated with the breach".

In a careful and extensive decision, the Court rejected the tenant's position. While it expressed sympathy for the tenant's argument, it refused to depart from binding precedent. In the Court's opinion, the change advanced by the tenant could have a "dramatic impact" on leases already made. The Court emphasized the value of *stare decisis* in that it promotes "consistency and predictability in the law".

The tenant has filed an appeal. Arguments were submitted the week of November 11, 2024.

2. SCOPE OF THE SIX-YEAR LIMITATION PERIOD UNDER THE RPLA

A recent case has led some to question whether the six-year limitation period under section 17(1) of the *Real Property Limitations Act* (the "***RPLA***") only applies to claims by a landlord for arrears of rent, or whether it also applies to claims by a tenant for a refund of overpaid rent.

Under a typical net lease, flow-through amounts of additional rent are paid in provisional instalments, based on estimates that are reconciled at the end of the fiscal period. Similar reconciliation payments can arise under percentage rent regimes and following measurement of rentable areas. Sometimes the tenant is entitled to a refund or credit, and sometimes it owes a top-up amount.

While the general limitation period under section 4 of the *Limitations Act, 2002* is two years from the date of discoverability, section 17(1) of *RPLA* specifies a limitation period of six years after the rent was due.

Conventionally, “rent” is perceived as capturing only payments from a tenant to its landlord. Refunds owed to the tenant are not generally considered to qualify as “rent”. On that basis, the six-year limitation period would not be available to a tenant claiming a refund. In *914068 Ontario Inc v 713949 Ontario Inc.,* the Ontario Superior Court of Justice held that the tenant’s claim for an adjustment of utility charges in its favour was subject to the two-year limitation period (though the tenant did not appear to claim that the applicable limitation period should have been six years).

A theory is circulating, to the effect that the recent decision of the Ontario Superior Court of Justice in *Rexall Pharmacies Ltd v 1178860 Ontario Limited* supports the availability of the six-year limitation period to a tenant’s claim for a rental adjustment in its favour. In the case, the lease called for calculation of the tenant’s share of taxes based on its proportionate share of area. Since the commencement of the lease term, however, the landlord incorrectly calculated the tenant’s share of taxes based on valuation notes provided by the assessor. For a period of 17 years, the tenant paid in accordance with the landlord’s incorrect calculation.

In 2017, the tenant started underpaying the taxes charged, and in 2023 it brought an action for, *inter alia*, an accounting of taxes going back to commencement of the lease term. The landlord defended, in part, on the basis that the tenant’s right to an accounting was limited to only the two years prior to the initiation of the court proceedings.

The court held that taxes constitute “rent” within the meaning of the *RPLA*. Thus, it held that “the claims for determination of the realty taxes” can go back six years. On its own, this wording suggests that it is immaterial whether the adjustment to be made is in favour of the landlord or the tenant. However, in the conclusion of the ruling, the court granted the ***landlord*** the right to collect a short fall in property taxes from the tenant (calculated based on the correct proportionate share method) going back six years. The Court dismissed the tenant’s claim for an accounting. The ruling leaves the reader wondering if the Court would have held that the six-year period applied if the status of accounts were such that a payment was owed to the tenant.

3. EXCLUSIVES AND RESTRICTIVE COVENANTS – CHANGES TO THE *COMPETITION ACT*

Recent changes to the *Competition Act* (the "***Act***") may result in the unenforceability of some exclusive use clauses and restrictive covenants.

In October 2022, the Competition Bureau launched a market study of grocery store competition in Canada in response to cries from the Canadian public for lower prices, more convenience and greater innovation. On June 27, 2023, the Bureau released the *Competition Bureau Retail Grocery Market Study Report*, which recommended that the government take measures to limit exclusive use covenants in the grocery industry. On September 14, 2023, the federal government announced its intention to amend the *Act* and, shortly thereafter, Parliament introduced Bill C-56, dubbed the *Affordable Housing and Groceries Act*. On December 14, 2023, the bill was passed with the result that on December 15, 2024, any agreement in Canada that "lessens competition" may be subject to an order under the *Act*.

In its previous form, section 90.1(1) of the *Act* allows the Bureau to apply to the Competition Tribunal for an order that a particular agreement prevents or lessens competition if the parties to the agreement are competitors. As of December 15, 2024, section 90.1(1) permits the Tribunal to make such an order even where the parties are not competitors. The provision provides: "if the Tribunal finds that a significant purpose of the agreement or arrangement, or any part of it, is to prevent or lessen competition in any market, it may make an order … even if none of the persons referred to in that subsection are competitors". The Tribunal is empowered to order a prohibition or behavioural order, such as prohibiting the enforcement of an exclusive use clause or restrictive covenant, or order "other measures to restore competition". It can also impose divestiture orders and financial penalties.

Although covenants in restraint of trade are contrary to public policy, and therefore subject to the general proposition of law that they are to be narrowly construed, the Courts have resisted that construal and upheld agreements restraining competition (including exclusive use covenants) in certain circumstances. For example, in *Russo v Field*, the Supreme Court of Canada upheld an exclusive covenant in the context of a shopping centre. It noted that if a limited number of prospective customers in a small shopping centre are faced with several prospective vendors of

the same goods and services, there may not be enough business to support the vendors, causing both them and the landlord to suffer. In some instances, the Courts have limited exclusive use clauses to the smallest ambit necessary to afford adequate protection. For example, in *Acktion Capital Co et al. v Everything for a Dollar Store (Canada) Inc*, the Ontario Court of Appeal upheld a lower court ruling that partially invalidated an exclusive use clause which prevented price-point retailers from selling products at $10 or less, because the tenant benefiting from the exclusive use clause only sold goods for $2 or less. The Court held that the exclusive use clause was unenforceable to the extent it prohibited the sale of products priced above $2.

Thus, although exclusive use clauses and restrictive covenants have long been subject to restraint in their application at law generally, the changes to the *Act* introduce a legislative regime for attacking them.

On August 7, 2024, the Competition Bureau published guidelines (the "**Guidelines**") outlining its preliminary enforcement approach to what it dubs "anti-competitive controls on the use of commercial real estate". The Guidelines describe exclusive use clauses and restrictive covenants as raising "serious competition concerns" and point to various sanctions that may be imposed by virtue of the new law. At the same time, the Guidelines also recognize that exclusive use clauses may enhance competition in certain circumstances.

The Guidelines state that exclusive use clauses will only be permitted in limited circumstances, such as where they are necessary to allow a new business to enter a particular market or to encourage a new investment. This suggests that an exclusive use clause will only be valid in cases where, without that protection, the business decision to enter the market could not be made. How the Bureau or the Tribunal will evaluate that degree of necessity is not specified by the Guidelines.

Boldly, the Guidelines state that the Bureau does not consider restrictive covenants to be justified outside of exceptional circumstances.

Why the Bureau is attempting to delineate between exclusive use clauses and restrictive covenants is not clear. In many ways, the anti-competitive protection offered by restrictive covenants and exclusive use clauses is the same. For example, consider a situation where a

supermarket landowner sells a portion of vacant land adjacent to its store. It would be ordinary for the supermarket landowner to encumber the sold parcel with a restrictive covenant prohibiting some degree of competition. By contrast, had the supermarket come to the property as a tenant under a lease, it would be ordinary for the lease to contain a clause prohibiting the landlord from allowing other premises to be used by certain types of competition. If the supermarket landowner developed the lands itself (to include multiple ancillary tenants) it would be ordinary for the ancillary tenants' leases to contain limited use clauses. Why the Bureau views these types of legal devices differently is perplexing.

Notably, the Guidelines don't address other provisions that lessen competition, such as radius clauses. Such clauses prevent a tenant from expanding into nearby markets, thus restricting availability of options to consumers. Perhaps they will not be perceived as "lessening competition" as they do not prohibit third party competitors from entering a market. Typical "prohibited uses" clauses that prevent the operation of liquidation outlets, discount stores, bingo halls, arcades, etc. are not mentioned in the Guidelines. Yet, these clauses restrict availability of options to consumers and may lessen competition.

The Guidelines state that if the clause or covenant is actually "necessary to allow a new business to enter the market or to encourage a new investment", the parties should consider imposing a time limit, covering fewer products or services, and referencing a smaller geographic area.

4. MARKET AND NEGOTIATION TRENDS

In the wake of the onset of the COVID-19 pandemic, landlords and tenant were including significant additional protections in their leases to deal with the pandemic and the specter of further emergencies. These protections often took the form of expansive "health emergency" clauses, which clarified landlords' rights to establish rules and close-off areas of the property, and imposed obligations on tenants to comply with their landlords' rules and contribute to associated costs. As of the date of writing, these clauses are appearing less and less frequently in executed leases. In light of the Ontario Court of Appeal's decision in *Niagara Falls Shopping Centre Inc v LAF Canada Company*, some landlords are regularly clarifying that the force majeure clause is not intended to have the effect of extending the lease term.

From the vantage point of our office, Class A office buildings continue to have low vacancy and attract handsome rents. The rest of the office market is still somewhat soft, and with “work from home” still a dominant aspect of office life, tenants are seeking flexibility into the future by negotiating for expansion and contraction rights, where possible. The retail sector is chugging along. We see lots of deals with percentage rent. With the closure of most major Canadian department stores in recent years, landlords are filling-in big box locations. Many retail leases now contain a redevelopment clause, whereby the landlord can terminate the lease to accommodate a redevelopment. Many retail landlords have their eyes on increasing density by adding residential uses. There continues to be relatively short supply in the industrial market. We have also noticed a trend of industrial landlords increasingly constructing “build-to-suit” projects.

Appendix I

1. *Daniels CCW Corporation v Shevchuk* (2023 ONSC 2955)
2. *Highway Properties Ltd v Kelly, Douglas* ([1971] SCR 562)
3. *Anthem Crestpoint Tillicum Holdings Ltd v Hudson's Bay Company ULC* (2022 BCCA 166)
4. *The Canada Life Assurance Company et al. v Aphria Inc* (2023 ONSC 6912)
5. *Real Property Limitations Act* (RSO 1990, c L.15)
6. *Limitations Act, 2002* (SO 2002, c 24, Sch B)
7. *914068 Ontario Inc v 713949 Ontario Inc* (2022 ONSC 172)
8. *Competition Act* (1985, c C-34)
9. *Rexall Pharmacies Ltd v 1178860 Ontario Limited* (2023 ONSC 4990)
10. *Russo v Field* ([1973] SCR 466)
11. *Acktion Capital Co et al. v Everything for a Dollar Store (Canada) Inc (*unreported)
12. *Niagara Falls Shopping Centre Inc v LAF Canada Company (*2023 ONCA 159*)*