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## “SUBSTANTIALLY COMPLETE” IS SUBSTANTIALLY UNCERTAIN

It is common for the commencement date of a commercial lease to be tied to a future event, for example, obtaining a building permit, a change of zoning, or site plan approval. Leases that do not have a fixed commencement date sometimes stir controversy over their enforceability. Often, parties to a lease tie the commencement date to the timing of “substantial completion” of certain construction work. In this News ReLease, we are concerned with the assumption that “substantial completion” is a well-defined term of certain meaning. Unfortunately, that’s not the case.

The Ontario Court of Appeal recently interpreted the meaning of “substantial completion”, in *Paletta International Corporation v Liberty Freezers London Ltd.*

### **Paletta’s Facts: Delays in Substantial Completion**

In 2010, the parties entered into an agreement to lease refrigerated premises in which the tenant would warehouse frozen food and carry on its frozen food distribution business. The parties agreed that the “lease shall commence upon substantial completion of the landlord’s work”. The landlord’s work listed several tasks that the landlord was to complete, including ensuring that certain features of the premises were in good working order *and* “in accordance with the Canadian Food Inspection Agency regulations and specifications”.

The parties set an informal target date of April 2011 for substantial completion of the landlord’s work, but by June 2011, the landlord’s work remained unfinished and the tenant was forced to cancel contracts with important clients. In October 2011, a year after signing the lease, the landlord’s work was still not finished and the tenant demanded a firm commencement date. By the end of March 2012, the tenant was fed up and advised the landlord that it would not proceed with the lease. The landlord nevertheless carried out the remaining work and ultimately found a replacement tenant. Then the landlord sued the original tenant for lost rent.

In 2019, the trial judge found that the landlord’s work was substantially complete about one month after the tenant walked away from the deal, namely when the project engineers determined that the premises was ready for commercial occupancy in accordance with the *Building Code*, and only minor work remained. On this basis, the trial judge awarded the landlord about two million dollars in damages.

### **The Appeal**

In a decision released in June of 2021, the Court of Appeal disagreed with the trial judge’s determination of when the landlord’s work was substantially complete. The Court focused on the lease requirement that the landlord’s work be completed “in accordance with the Canadian Food Inspection Agency regulations and specifications”.

The Court of Appeal found that the trial judge conflated substantial completion of the landlord’s work under the *Building Code* with substantial completion of the work in relation to the Canadian Food Inspection Agency (CFIA) requirements. The Court pointed out that the fact the premises were ready for occupancy did not mean that they were substantially complete as far as CFIA requirements were concerned, most notably with regard to refrigeration components. It is noteworthy that the term “substantial performance”, not “substantial completion”, is used in some provinces’ construction legislation; however, CFIA regulations do not use “substantial completion”. Essentially, the lease called for a concept of “substantial completion” that was not only undefined, but also entailed compliance with a regime that was particular to food handling.

Unfortunately for the landlord, the only evidence it had that its work complied with CFIA requirements was the registration of the premises by the Agency. Registration required that the occupant (who was, by then, the *replacement tenant*) demonstrate that its operation met the

Agency's standards. Although evidencing CFIA compliance does not depend solely on registration, the landlord could offer no other evidence that the specified work was CFIA compliant. As a consequence of having to use the replacement tenant's CFIA registration date to prove substantial completion of the landlord's work in accordance with CFIA regulations, the Court of Appeal held that **the term of the original tenant's lease did not commence until after the replacement tenant was in possession!** As a result, the landlord's claim for lost rent evaporated.

### **The Key Takeaway**

The key takeaway is that the meaning of "substantial completion" of the landlord's work was interpreted according to the wording of the lease. The parties had not taken the time to define "substantial completion", but they had described the landlord's work as having to comply with regulations pertaining to food safety. Thus, any *Building Code* stage of completion was irrelevant.

Misusing terms such as: "complete", "substantially complete" and "substantially performed", can have substantial consequences.

In most provinces, the meaning of "substantially performed" under construction legislation is dependent on the stage of completion of the construction contract. For example, Ontario's Construction Act defines "substantial performance" to be when the entire improvement or a substantial part of it is ready for its intended use, or is being used for the intended purpose, and the cost to

complete the remaining work or remedy deficiencies is not more than 3% of the first \$1,000,000.00 of the contract (i.e., \$30,000.00), 2% of the next \$1,000,000.00 of the contract (i.e., \$20,000.00), and 1% of the balance of the contract price.

In some leases, the parties define "substantially complete" to mean a stage of completion when the landlord's construction has been sufficiently completed to permit the tenant's construction to commence without material interference from the landlord's forces. Other times, the parties omit any reference to "substantial", tying the delivery of the premises to "completion". Ontario's Construction Act defines completion of a contract to be when the price to complete is not more than the lesser of 1% of the contract or \$5,000.00.

There is no one-size-fits-all definition of "substantially complete", nor is there a generally understood meaning of the term, as none is provided at common law or by statute. If lease outcomes (such as commencement of a fixturing period, commencement of the term, payment of a tenant allowance, etc.) are tethered to "substantial completion", it is important to focus on what the parties intend to serve as the critical juncture when the event will be considered to have occurred.

### **What about Enforceability of a Formula-Based Commencement Date?**

Interestingly, in *Paletta*, the determination of the term commencement date based on a formula (retroactively) was simply not an issue.

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