MINDEN GROSS LLP BARRISTERS AND SOLICITORS
145 King Street West, Suite 2200, Toronto, ON M5H 4G2
P. 416.362.3711 ▪ F. 416.864.9223 ▪ @MindenGross ▪ www.mindengross.com

Commercial Leasing Bulletin

Beware of Force Majeure Clauses: A summary of the Ontario Court of Appeal's Decision in *Niagara Falls Shopping Centre Inc. v. LAF Canada Company*

By Leonidas (Lenny) Mylonopoulos – Commercial Leasing Group – Minden Gross LLP

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On **March 8, 2023**, the Ontario Court of Appeal ("ONCA") released a concerning decision in the case of *Niagara Falls Shopping Centre Inc. v. LAF Canada Company*, 2023 ONCA 159 ("*Niagara Falls*"). It focused on a *force majeure* clause in a commercial lease between a retail landlord and a fitness facility tenant. The tenant was forced to stop all of its business operations in the leased premises by government-mandated shutdowns related to the COVID-19 pandemic (the "Pandemic") for periods of closure totaling approximately nine months. The Court interpreted the *force majeure* clause as having the following effects:

- It excused the landlord for its breach of the covenant for quiet enjoyment.
- The tenant had to pay rent to the landlord for the shutdown periods.
- The term of the subject lease had to be **extended** for a period equivalent to the shutdown periods (i.e., nine months).
- The tenant would **not** be required to pay rent to the landlord for the extension period.

The result should ring alarm bells for commercial landlords and tenants alike. Although it is ostensibly a welcome result for tenants, it creates a great deal of commercial uncertainty in the industry and is very difficult to reconcile with previously-established Ontario jurisprudence that appeared to confirm that landlords are not placed in breach of the covenant for quiet enjoyment as a result of government-mandated Pandemic restrictions.

Background

In response to the Pandemic, the Ontario government enacted laws compelling non-essential workplaces to fully shutdown or severely limit their business operations. The wavering governmental policies in response to the Pandemic created an unpredictable environment where many retail tenants experienced a series of shutdowns punctuated by periods of stringent operational limitations (e.g., capacity limits). The restrictions negatively impacted retail tenants of different sizes and uses. The group most acutely affected by these restrictions included "big box"

tenants who paid expensive rents for large spaces designed to accommodate large numbers of people, such as cinemas, entertainment/recreational facilities, gyms, and fitness facilities.

The result was a truly unforeseeable event that could not reasonably be ascribed to the fault of any single landlord or tenant. It was the most quintessential example of a *force majeure* event. In Canada, a *force majeure* clause is a contract provision designed to relieve a contracting party from a contractual obligation when a supervening event beyond its control makes performing that obligation impossible. Prior to the Pandemic, the *force majeure* clause (nearly universal in Canadian commercial leases) was relegated to the realm of boilerplate contract provisions over which most lawyers did not care to argue; but the Pandemic transformed *force majeure* into a hot topic in the legal community. We knew that most, *but not all*, of these *force majeure* clauses said that a force majeure event does not relieve a tenant of its rental obligations. Nevertheless, due to the unprecedented shutdowns caused by the Pandemic, lawyers questioned whether the Courts might be convinced to interpret *force majeure* clauses as relieving a tenant of its rental obligations to some extent, especially where the clause did not expressly preclude such relief.

Litigators quickly jumped into the fray and brought these very questions directly before the Courts. Ultimately, in Ontario, the resounding legal consensus appeared to be as follows:

- A landlord was **not** in breach of its lease (including the covenant for quiet enjoyment) just because its tenant was subjected to government-mandated Pandemic restrictions on business operations.
- Absent some express contract provision to the contrary, a tenant will not be relieved of its rental obligations as a result of a *force majeure* clause.

However, *Niagara Falls* has re-problematized the interpretation of *force majeure* clauses in the context of the Pandemic.

The Lower Court Decision (2022 ONSC 2377)

The tenant experienced approximately nine months of shutdowns throughout 2020 and 2021, with some intervening periods when it was permitted to operate subject to capacity limits. The tenant stopped paying rent when the Ontario government instituted a new Shutdown on December 26, 2020.

The landlord initiated a legal action to recover all unpaid rent. As part of its argument, the landlord said that the shutdowns were “restrictive laws” within the meaning of the *force majeure* clause, so it was exempted from its obligation under the lease to provide the tenant with quiet enjoyment of the leased premises. The judge accepted this submission.

The tenant argued that it was not obligated to pay rent during the shutdown periods because of frustration and unjust enrichment, abatement at common law and under the terms of the lease, and the *force majeure* clause. In particular, the tenant argued that: (i) during the periods that the fitness

facility was shutdown, it was relieved of its rental obligations; (ii) during the period of the government-mandated capacity limits for the fitness facility, its rental obligations were reduced in proportion to those restrictions; and (iii) the extension provision in the *force majeure* clause **[bolded in the excerpt below]** (the "Force Majeure Extension Provision") required the term of the lease to be extended for a period equivalent to the shutdown periods (the "Force Majeure Extension Argument").

The *force majeure* clause read as follows:

> "22.3 FORCE MAJEURE. *If either party is delayed or hindered in or prevented from the performance of any act required hereunder because of* strikes, lockouts, inability to procure labour or materials, retraction by a Governmental Authority of the Building Permit once it has already been issued, failure of power, *restrictive laws*, riots, insurrection, war, fire, inclement weather or other casualty *or other reason of a similar or dissimilar nature beyond the reasonable control of the party delayed, financial inability excepted* (each, a "Force Majeure Event"), subject to any limitations expressly set forth elsewhere in this Lease, **performance of such act shall be excused for the period of delay caused by the Force Majeure Event and the period for the performance of such act shall be extended for an equivalent period** (including delays caused by damage and destruction caused by such Force Majeure Event). *Delays or failures to perform resulting from lack of funds or which can be cured by the payment of money shall not be Force Majeure Events*. Force Majeure Events shall also include, as applied to performance of Tenant's acts, hindrance and/or delays in the performance of Tenant's Work or Tenant's obtaining certificates of occupancy (or their equivalent) or compliance for the Premises by reason of any of the following: (i) any work performed by Landlord in or about the Project from and after Delivery (including, but not limited to, the completion of any items of Landlord's Work remaining to be completed); and/or (ii) the existence of Hazardous Substances in, on or under the Premises not introduced by Tenant [emphasis added]."

The judge rejected all of the tenant's defences. In particular, she held that the *force majeure* clause did not relieve the tenant of its rental obligations during the shutdown periods. Further, she dismissed the Force Majeure Extension Argument because: (i) accepting it would lead to a "commercially absurd" result; and (ii) the Force Majeure Extension Provision was intended to deal with only a time-limited event in the lease, such as a repair obligation, not the landlord's covenant for quiet enjoyment.

The Appeal Decision (2023 ONCA 159)

The tenant appealed the motion judge's decision to grant summary judgment to the landlord. The ONCA allowed the tenant's appeal on the Force Majeure Extension Argument, holding that:

- The *force majeure* clause excused the landlord's breach of the covenant for quiet enjoyment during the shutdown periods because it was the government's "restrictive laws" that prevented the landlord from performing this obligation. **However, this triggered the Force Majeure Extension Provision, which necessitated that the lease term be extended for a period equivalent to the shutdown periods (being the period during which the landlord was unable to perform its obligation).**
- The *force majeure* clause did **not** relieve the tenant of its rental obligations **during** the shutdown periods.
- The tenant shall not be obligated to pay rent for the extension period **because it had already been required to pay rent for the shutdown periods.**

Key Thoughts and Take-Aways

This decision is obviously of great interest to the Canadian commercial leasing industry for many reasons.

First, the decision will have widespread application in the industry. Most standard form landlord leases in Canada are drafted very similarly to the *force majeure* clause in *Niagara Falls* (including the Force Majeure Extension Provision). Accordingly, the interpretation of this provision in *Niagara Falls* could readily be applied to many Canadian commercial leases. Thus, the decision could lead to a flood of similar legal actions by tenants in similar situations. This could expose many landlords (and tenants) to unexpected liabilities.

Second, the ONCA's interpretation of the intent and effect of the Force Majeure Extension Provision is completely at odds with industry expectations. The very fact that it is common in standard form landlord leases in Canada suggests that landlords never intended it would be interpreted to have the drastic effect of automatically extending the term of the lease on a rent-free basis whenever the landlord allegedly breaches the lease. Rather, the intent of the provision is precisely that which was articulated by the motion judge. It is simply meant to clarify that where the default pertains to the performance of an act that must be completed by a set deadline, the deadline gets delayed by a period equivalent to the *force majeure* event.

Third, the decision creates a significant amount of commercial uncertainty in the industry. It strikes directly at the heart of one of the most fundamental lease provisions: the term of the lease. Here are some of the types of confusion that may result from this decision:

- If the tenant has an option to extend or renew the term of the lease, when does the Court-mandated extension period occur? Is it after the initial term of the lease or the option term? How does it affect the tenant's deadline for exercising its option to extend or renew the lease or the amount of rent payable for the option period? For context, many leases say that the option term rent shall be negotiated by the parties based on a pre-defined formula, often expressed as being not less than the rent payable for the last

year of the term. As such, the extension period could create uncertainty as to how to properly calculate the option term rent.

- Uncertainty around the proper expiry date of leases could be particularly problematic for landlords (or prospective purchasers and mortgagees of the real property) who have entered into binding agreements for the re-leasing or redevelopment.

This commercial uncertainty is bad for landlords and tenants alike.

Fourth, the entire decision hinges on the notion that the shutdowns placed the landlord in breach of the covenant for quiet enjoyment; however, this does not appear to have been framed as a legal issue to be reviewed and answered by the Court; it was simply an assumption that was accepted by both Courts. This assumption appears to fly in the face of previously established Ontario jurisprudence, which said that, absent some express contractual provision to the contrary, a landlord is not considered to be in breach of the covenant for quiet enjoyment as a result of the government-mandated Pandemic restrictions on a tenant's business operations.

In particular, in the recent case of *Hudson's Bay Company ULC v. Oxford Properties et al.*, 2021 ONSC 4515 ("*HBC v. Oxford*"), the Ontario Superior Court of Justice held that the landlord was not in breach of the covenant for quiet enjoyment (nor its obligations to operate the mall in accordance with first-class shopping centre standards) as a result of the government-mandated Pandemic restrictions on the tenant's business operations (this decision was subsequently affirmed by the ONCA in *Hudson's Bay Company ULC Compagnie de la Baie D'Hudson SRI v. Oxford Properties Retail Holdings II Inc.*, 2022 ONCA 585). The Court also held that, in order to establish a breach of the covenant for quiet enjoyment, there must be a specific act by the landlord that causes the interference. In that case, the landlord did not do anything that caused the closure of the mall or the restrictions related to capacity.

The holding in *HBC v. Oxford* generally agrees with the established view that the covenant for quiet enjoyment, whether at common law or as enshrined in most Canadian commercial leases, is only engaged by an interference with the tenant's business that is caused by the landlord or a person claiming through the landlord. This does not readily capture interferences caused by third parties that are wholly outside the landlord's control (e.g., government actions).

In fact, the quiet enjoyment clause in the tenant's lease in *Niagara Falls* reflected this limited view of the scope of the landlord's covenant for quiet enjoyment. It read as follows:

> "Upon payment by Tenant of the Rent and the observance and performance of all of the agreements, covenants, terms and conditions on Tenant's part to be observed and performed, Tenant shall quietly enjoy the Premises for the Term without hindrance or interruption by Landlord or any other person or persons lawfully or equitably claiming by, through, or under Landlord, subject to the terms of this Lease."

There is no indication that the landlord itself did anything to interfere with the tenant's use of the leased premises during the shutdowns.

Last, there appears to be an irreconcilable tension between the Court's main findings. On the one hand, the tenant's obligation to pay rent was **not** excused by the *force majeure* clause, so the tenant had to pay rent for the shutdown periods. On the other hand, the landlord's alleged breach of the covenant for quiet enjoyment, which would be excused by the *force majeure* clause if it were a breach, necessitated an extension of the lease and a full rent abatement for the extension period.

The Court does not offer an adequate explanation as to why the use of the *force majeure* clause for the landlord's benefit would also entail a rent abatement for the extension period, to the landlord's detriment. Even assuming it is correct to say the *force majeure* clause requires an extension of the lease, the clause does not say anything about the tenant being relieved of its rental obligations during the extension period.

If the landlord's breach is clearly excused by the *force majeure* clause, why should it be punished by the rent abatement? Ultimately, the rent abatement appears to have been *read into* the lease by the ONCA as an equitable exchange for the fact that the tenant was required to pay rent for the shutdown periods. The net result undermines the Court's finding that the *force majeure* clause did not relieve the tenant of its rental obligations under the lease. This is an outcome that is contrary to what we thought was established law in this area.

The uncertainty created by this decision is very concerning and leaves practically all leases in a state of flux. One can only hope that the decision will be carefully reviewed by the Supreme Court of Canada and appropriate guidance will be given to landlords and tenants alike.

We provide regular updates on commercial leasing issues in Canada. If you have any questions or would like to obtain legal advice on any leasing issues or commercial leasing litigation, please contact any lawyer in our **Commercial Leasing Group**.

Commercial Leasing Group

Stephen Posen
Chair, Commercial Leasing Group
e: sposen@mindengross.com
p: (416) 369-4103

Michael Horowitz
Chair, Commercial Leasing Group
e: mhorowitz@mindengross.com
p: (416) 369-4121

Catherine Francis
Partner, Litigation Group
e: cfrancis@mindengross.com
p: (416) 369-4137

Ian Cantor
Partner, Litigation Group
e: icantor@mindengross.com
p: (416) 369-4314

Christina Kobi
Partner, Commercial Leasing Group

Boris Zayachkowski
Partner, Commercial Leasing Group

e: ckobi@mindengross.com
p: (416) 369-4154

Benjamin Radcliffe
Partner, Commercial Leasing Group
e: bradcliffe@mindengross.com
p: (416) 369-4112

Steven Birken
Partner, Commercial Leasing Group
e: sbirken@mindengross.com
p: (416) 369-4129

Alyssa Girardi
Associate, Commercial Leasing Group
e: agirardi@mindengross.com
p: (416) 369-4104

e: bzayachkowski@mindengross.com
p: (416) 369-4117

Melodie Eng
Partner, Commercial Leasing Group
e: meng@mindengross.com
p: (416) 369-4161

Leonidas (Lenny) Mylonopoulos
Associate, Commercial Leasing Group
e: lmylonopoulos@mindengross.com
p: (416) 369-4324

Benji Wiseman
Associate, Commercial Leasing Group
e: bwiseman@mindengross.com
p: (416) 369-4114