MINDEN GROSS LLP

Newsletter

TOPICS:

Property Leasing

Recent Developments *of* Importance

PART 1

ALLOCATION OF RISK UPDATE: Interplay *of* Insurance, Indemnity & Release Clauses

Any analysis with respect to the allocation of risk in a commercial lease will inevitably draw upon the principles set out by the Supreme Court of Canada in the "Trilogy": (1) *Pyrotech Products Ltd. v. Ross Southward Tire Ltd.*, (1975) [1976] 2 S.C.R. 35; (2) *Cummer-Yonge Investments Ltd. v. Agnew-Surpass Shoe Stores Ltd.*, (1975) [1976] 2 S.C.R. 221; and (3) *Smith v. T. Eaton Co.*, (1977) [1978] 2 S.C.R. 749. Each of these Trilogy cases involved attempts by a landlord (or its insurer by way of subrogation) to recover damages from a tenant as a result of fire damage caused by each

tenant's negligence. In all three cases, the Supreme Court found in favour of the tenant and dismissed each landlord's action on the basis of the principle of immunity. The Supreme Court established the principles specifying that in a landlord-tenant relationship where there is an express obligation by one party to obtain property insurance or an express obligation by the tenant to contribute to the costs of insurance, each operates as an assumption of risk for loss or damage caused by the other party, including for acts of negligence. Canadian Courts continue to rely on the Trilogy principles in dismissing actions brought by innocent parties (or their insurers) against negligent parties, suggesting that only the most clear, express, and unambiguous language will provide an exception to the principle of immunity.

In *Deslaurier Custom Cabinets Inc*. 2017 ONCA 293, (leave to appeal to SCC refused), 2017 *CanLII 68350*, the tenant leased several units in the landlord's commercial building. On January 1, 2009, a fire occurred due to repairs that were being made by the landlord's contractors, causing significant damages to the building including the tenant's premises and its property. The building was a total loss and was eventually demolished. The tenant made a claim to its insurer but the amount it received was insufficient to fully cover its losses. The tenant brought an action against the landlord to recover costs for its uninsured property and the tenant's insurer sought recovery of the subrogated loss. The landlord defended on the basis that: (1) the tenant assumed the risk of loss; and (2) if the tenant had added the landlord as an additional insured to its policy as required by the lease, the tenant and its insurer would be precluded from claiming against the landlord.

The motion judge held that the landlord's indemnity took priority over the tenant's obligation to insure – meaning, the landlord had assumed responsibility to indemnify the tenant in respect of any damage to its property and business caused by the landlord's actions or actions of its agents and contractors. The Ontario Court of Appeal rejected the motion judge's interpretation of the lease and decision. Instead, the Court found that the tenant's obligation to insure against all risk of loss or damage to its own property caused by fire relieved the landlord from liability. In addition, the Court held that the tenant's insurer should not be able to bring a subrogated claim against the landlord because it would not have been able to bring such a claim if the tenant had complied with its obligations under the lease to name the landlord as an additional insured.

While the tenant's application for leave to appeal this decision was pending, the Supreme Court of Canada directed the Court of Appeal to reconsider its decision in light of the Supreme Court's ruling in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37. The Court of Appeal did so, but noted that the *Ledcor* principles regarding standard form contracts would not apply to this case as the lease in question was a negotiated contract and therefore, the standard of review applied in its previous decision was correct. Once again, the tenant sought leave to appeal, but on October 9, 2017, the SCC provided finality by dismissing the tenant's application for leave. By refusing leave to appeal, the Supreme Court inferentially affirmed the precedential value of the Trilogy principles and that only in the clearest of cases will it be possible to rebut the principle of immunity.

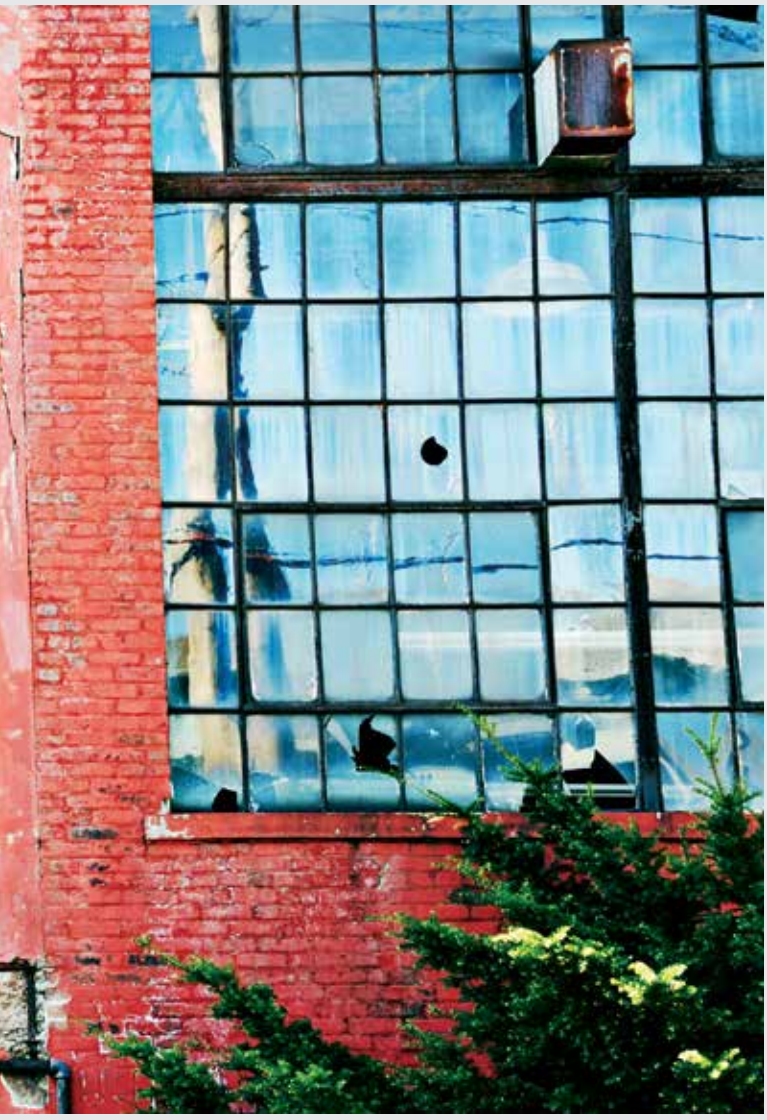
But just when all hope seemed lost for landlord-insurers, the Ontario Court of Appeal threw them a life-line with *Royal Host v. 1842259 Ontario Ltd.,* 2018 ONCA 467.

In *Royal Host*, the tenant leased premises to operate a restaurant. A fire in the tenant's restaurant kitchen caused damage to the building. The damage was covered by the fire insurance covenanted by the landlord to be taken out under the lease, for which the tenant contributed to premiums. The insurer indemnified the landlord but brought a claim against the tenant through its right of subrogation. Relying on the Trilogy principles, the trial judge held that the insurer's claim was barred on the basis that when a landlord covenants to obtain insurance for fire damage, the landlord is barred from recovering losses from the tenant absent clear, express, or unambiguous language in the lease stating otherwise.

However, the Ontario Court of Appeal found that the motion judge erred in his interpretation of the lease and the application of the Trilogy principles on

the basis that there was clear, unambiguous, and sufficient language that rebuts the principle of immunity. In *Royal Host*, the tenant's indemnity clause included "notwithstanding" language which explicitly states that "the tenant remain[ed] liable for its own negligence notwithstanding the landlord's covenant to purchase insurance and the tenant's contribution for the cost of that insurance." As a result, a subrogation claim in relation to the exception clause would not have been contrary to the parties' intentions and the insurer could bring a subrogated claim for damages. The Court of Appeal found this language sufficient to allow the landlord's insurer to bring a claim against the tenant (note: the Court did not rule that the tenant was negligent and was responsible for the loss, but rather that the landlord's insurer was not prevented from bringing a claim for same.)

Although we would not call the decision in *Royal Host* surprising given the express language in question, it is interesting to see our Courts opening this window for insurers despite all the previous case law and general reluctance to do so in the past. We now have a small handful of cases, including *Royal Host* and *Lee-Mar Developments Ltd. v. Monto Industries Ltd.* [2000] O.T.C. 250 (Ont Sup Ct J), affirmed (2001), 146 O.A.C. 360 (CA), which illustrate that it is possible to contract out of the Trilogy principles.



Subtenant's Security of Tenure Following Abandonment by Tenant

What right to stay does a subtenant have? Subject to a subtenant's statutory rights (discussed below), in the event the head lease is cancelled, terminated, or surrendered, the subtenant cannot force a head landlord to recognize its tenancy or allow it to remain in possession of the subleased premises unless there is privity of contract between the landlord and the subtenant (e.g., non-disturbance agreement or tri-party consent to sublease) and the contract in question provides non-disturbance comfort.

In the Province of Ontario, subtenants enjoy statutory rights pursuant to the *Commercial Tenancies Act* (Ontario), R.S.O. 1990, c. L.7 ("CTA"): Section 17 (Surrender of Lease); Section 21 (Termination of Lease and Relief of Forfeiture); and Section 39(2) (Bankruptcy of Tenant). In particular, Section 17 provides that if the lease is surrendered, the subtenant becomes the tenant of the landlord under the terms of the sublease. In other words, the landlord steps into the shoes of the sublandlord (the tenant) and accepts the sublease as if it had entered into it directly with the subtenant.

In *Smiles First Corporation v. 2377087 Ontario Ltd.*, 2018 ONCA 524, the Ontario Court of Appeal grappled with the issue of whether a landlord's acceptance of rent from the applicant, who claimed to be an assignee, amounted to a recognition of an equitable assignment. The Court also ruled on the impact a lease abandonment has on a subsisting sublease.

On January 12, 2015, the landlord entered into a lease with the tenant. The tenant then subleased the premises to the applicant subtenant (Smiles First). Under the sublease, the subtenant agreed to pay a significantly higher rent than the tenant was paying to the landlord under the head lease.

Disputes later arose between the parties under both the head lease and the sublease. On October 31, 2016, the tenant and subtenant executed an assignment of the head lease to the subtenant, but without the head landlord's consent. In November 2016, the head landlord proposed a settlement agreement to the tenant and subtenant which, among other things, required the tenant to vacate the premises. The tenant signed the agreement and abandoned the premises as of November 1, 2016. The subtenant did not execute the settlement agreement but began paying rent in November 2016, which was accepted by the landlord.

Not surprisingly, Smiles First argued that it was the "official tenant" under the head lease by virtue of the executed assignment, and in the alternative, even if the assignment was invalid, that the head lease was equitably assigned once the landlord accepted rent from Smiles First after the head tenant abandoned the premises. However, the landlord took the position that

the applicant (Smiles First) was a month-to-month occupant (and not an assignee) under the lease. Soon after, the landlord provided Smiles First with a notice of termination of the monthly tenancy. Smiles First sought a declaration that the assignment (as between tenant and subtenant) was binding and an order for relief from forfeiture.

The application judge found that the assignment was not legally effective because the landlord's consent, as required by the terms of the assignment clause in the head lease, was not obtained. As well, the head lease only allowed the tenant to assign its rights to the lease if it was not in default, but in this case, the tenant was in arrears of rent.

The application judge also found that the landlord's acceptance of the rent during the time when the parties were engaged in settlement negotiations was not an indication of the landlord's intention to treat the proposed assignment as valid. Moreover, neither the landlord's acceptance of rent nor its willingness to allow the proposed assignee to remain in possession of the premises automatically results in an equitable assignment of the lease. The application judge further held that the acceptance of rent did not constitute a waiver or estop the landlord from asserting its rights under the lease.

The applicant appealed the decision but the Ontario Court of Appeal held that there was no reversible error in the application judge's analysis of the issues regarding the assignment, or lack thereof, of the lease. Although the Court found the applications judge was correct in finding that the tenant had abandoned the head lease as part of its settlement with the landlord, the Court held that the judge had erred in accepting the landlord's argument that the surrender of the head lease resulted in termination of the sublease and the judge's finding that Smiles First was not a subtenant. However, the application judge had properly refused Smiles First's request for a declaration that pursuant to the sublease it was entitled to remain in the premises "on the same terms and conditions as the Head Lease." The Court explained the law on this area is well settled (citing case law and Section 17 of CTA) and that when a head lease is surrendered, the sublease survives and the subtenant is entitled to possession of the premises "under the terms of the Sublease." Accordingly, Smiles First was entitled to relief against the landlord's attempt to terminate its possession of the premises (on the basis that it was merely a monthly tenant) and the termination notice was of no force or effect.

What makes the Smiles First case especially interesting is that a subtenant who attempted to take an unlawful assignment of the head lease was still entitled to relief from forfeiture as a subtenant.

Special acknowledgement and thanks to Stephen Messinger and Nusrat Ali (Student-at-Law), for their valuable assistance in preparing this article.

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Stay tuned for Part 2 in our Fall 2019 issue in November

Are You Ready?

The New Construction Act

Prompt Payment *and* Adjudication *are* Almost Here!

It's been over a year since the first set of amendments to Ontario's *Construction Lien Act* (renamed *Construction Act*) were proclaimed. Here's what is in force and what's to come later this year.

Two dates to remember:

July 1, 2018: amendments come into force, except for prompt payment and adjudication

October 1, 2019: prompt payment and adjudication of construction disputes in force

Since July 1, 2018, there have been further amendments to the Act and regulations, as recently as May 2019. There may be more amendments to come.

Transition Rules

when do the new changes apply?

- *Construction Lien Act* (pre-July 1, 2018 changes):
  - Contracts entered into before July 1, 2018
  - Contracts after July 1, 2018, where procurement process began before July 1, 2018
  - Leases entered into before July 1, 2018, where a contract for improvement was entered into or procurement process commenced between July 1, 2018, and December 5, 2018
- *Construction Act* (with July 1, 2018 changes)
  - Contracts entered into on or after July 1, 2018
  - Contracts after July 1, 2018, where procurement process began before Oct 1, 2019
- *Construction Act* (with July 1, 2018 changes, prompt payment and adjudication)
  - Contracts entered into on or after October 1, 2019

THE JULY 1 2018 Highlights: New Deadlines, New Forms

1. Lien periods:
   a. 60 days to preserve a lien (up from 45)
   b. 90 days to perfect a lien (from 45)
   c. Must publish notice of contract termination
2. Holdbacks
   a. Mandatory release, unless the payor publishes notice of the amount it refuses to pay
   b. Annual or phased holdbacks for certain contracts of $10 million or more
   c. Alternative security: letter of credit or holdback release bond
   d. Landlords required to holdback 10% from payment for an "improvement accounted for" in a lease, renewal, or other agreement with Landlord as a party
   e. Nothing prevents a landlord from being an "owner" if it meets the definition in the Act
3. Right to Information
   a. Landlords must respond within 21 days to a written request for information including "state of accounts" (a defined term) between the landlord and the tenant
4. New Substantial Performance and Completion Thresholds
   a. Substantial performance threshold increased to $1 million from $500,000:
      i. 3% of the first $1 million of the contract price
      ii. 2% of the next $1 million, and
      iii. 1% of the balance
   b. Completion is deemed achieved when the cost to complete is the lesser of 1% of contract price and $5,000
5. Multiple Improvements
   a. Multiple improvements in a contract can be deemed under separate contracts if the contract so provides and the improvements are on non-contiguous lands
6. Bonds
   a. Public contracts of $500,000 or more require a labour and material payment bond and a performance bond with coverage of at least 50% of the contract price
7. Condominiums
   a. Unit owners can vacate a lien registered against the common elements of a condominium by paying into court or posting security in the amount of the proportionate share of the unit owner's interest in the common elements
8. Capital Repairs added to definition of "Improvement"
   a. Includes a repair intended to extend the normal economic life or to improve the value or productivity but does not include maintenance work to prevent deterioration or to maintain in a normal, functional state

THE NEW: Prompt Payment and Adjudication – October 1, 2019

Prompt Payment

Upon receipt of "proper invoice", Owner has:

- 28 days to pay, 14 days to give notice disputing
- must pay all undisputed amounts within the original 28 days

If Owner pays full amount, Contractor has:

- 7 days to pay subcontractor or
- 35 days to deliver notice of non-payment to subcontractor

If Owner does not pay, Contractor has:

- 7 days to deliver notice of non-payment to subcontractor AND undertake to refer the matter to adjudication, or
- 35 days to pay subcontractor

If Owner pays in part, Contractor has:

- 7 days to pay subcontractor from the amount received from Owner, deliver notice of non-payment to subcontractor for balance, and undertake to refer to adjudication, or
- 7 days to pay subcontractor from amount received from Owner and 35 days to pay subcontractor the balance, or
- to deliver notice of non-payment to subcontractor within prescribed deadlines (similar deadlines apply to the subcontractor to pay the sub-subcontractors, and so on down the construction chain)

Invoices:

- Monthly invoicing, parties can agree to a different schedule
- "Proper invoice" is defined with minimum requirements; parties can add their own requirements so long as don't conflict with the Act
- Cannot contract out of prompt payment deadlines once a "proper invoice" is received
- Cannot be conditional on pre-certification or owner approval (some exceptions)

Adjudication

Mandatory for prescribed disputes, other disputes parties can agree.

Cannot contract out of adjudication.

ADR Chambers has been selected to act as the Authorized Nominating Authority (ANA) and run the adjudication process and select/train adjudicators.

Parties cannot pre-select adjudicator in contract, selected once adjudication commences.

Timing for adjudication is short:

- After initiating notice, adjudicator has 4 days to agree or ANA appoints within 7 days
- Initiating party has 5 calendar days to provide documents it intends to rely upon
- Adjudicator must render decision within 30 days of receiving documents; deadline can be extended by agreement of the parties and adjudicator
- Decision is binding unless and until same matter is determined in court or by arbitration
- Limited judicial review
- Must pay within 10 days of decision or contractor can suspend work with costs

Tips:

- Update your precedent construction contracts and lease templates
- Be conservative with dates/deadlines during the transitional period if not sure what regime applies
- Train staff to understand the new legislation and the new forms
- Ensure internal approvals and processes are in place to meet these deadlines
- Ensure your records and documents are accurate, complete and readily available
- Landlords: be prepared to respond to s. 39 inquiries

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Firm News

Congratulations Steven Pearlstein!

Minden Gross LLP is pleased to announce that **Steven Pearlstein** was selected by his peers and the OBA as the recipient of the 2019 Award of Excellence in Real Estate Law. The Award recognizes Steven's exceptional leadership and contributions to the practice of real estate law in Ontario. He received the award on June 17. He was profiled in *Law Times* for receiving this prestigious award.

Congratulations Ryan Gelbart and Christina Kobi!

Minden Gross LLP congratulates **Ryan Gelbart** and **Christina Kobi** who have been selected to be a part of Thomson Reuters' advisory board for Practical Law.

Professional Notes

Sepideh Nassabi posted five articles including "Kim Kardashian Drops Kimono Brand Name Amid Outcry" on July 2 and "Bucks and Warriors and Monster…Oh My!: Raptors Trademark Battle Off The Court" on June 11.

Reuben M. Rosenblatt LLD, QC, LSM, was mentioned in *Law Times* on July 2 in relation to an opinion he wrote on the exposure LAWPRO could incur in an investigation.

Michael Goldberg's article "Part 3 - Shareholders Agreements, The Act, and the Non-Specialist Advisor - The Impact of Control" was published in the June edition of *Tax Topics.* Part two and three of this article also appeared in the June and July editions of *The Estate Planner*.

Samantha Prasad published two articles in *The Fund Library* including "Spousal tax strategies, part 1" on June 25. *The TaxLetter* published her article "Federal Budget Roundup - Love and Taxes" in June.

Joan Jung became a member of the Program Committee for the Annual Conference of the Canadian Tax Foundation.

Arnie Herschorn's article "Current Approaches to Contractual Interpretation: Ambiguity and Palpable and Overriding Error" was published in the July 2019 edition of the *Canadian Business Law Journal*.

Sheila Morris was named as a Member-at-Large of the OBA's Elder Law Section with the term beginning July 1.

Howard Black participated in a panel discussion on "Ethical and Professional Issues in Estate Mediation" as part of a program sponsored by Osgoode Hall Law School Professional Development on June 5. He presented "Planning for the Unexpected – Don't leave Your Future to Chance" to RBC on May 21.

Andrew Elbaz, **Alexander Katznelson**, and **Jessica Thrower** acted for Freckle Ltd. as it completed a reverse takeover transaction and began trading on the TSX-V in late June. **Andrew**, **Alexander**, and **Jessica** acted for Eguana Technologies Inc. as it completed the first tranche of its brokered private placement offering of $3 million.

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Ryan Gelbart, **Sasha Toten**, **Tracy Kay**, and **Michael Goldberg** acted for Powerflow as it closed its acquisition by Kinderhook-backed Adell Group in late June.

Brian Temins, **Samantha Prasad**, and **Sasha Toten** acted for Area One Farms as they announced the first close of Fund IV with commitments totaling $120 million along with an announcement of The Fund's first two farm partnership allocations.

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