

HAVE A LITTLE FAITH IN ME: GOOD FAITH IN LEASING LATELY

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This bulletin explores the duty of good faith in commercial leasing, which grows out of the Supreme Court of Canada's recent decisions in *C.M. Callow Inc. v Zollinger*^[1] ("**Callow**") and *Wastech Services Ltd. v Greater Vancouver Sewerage and Drainage District*^[2] ("**Wastech**") and earlier *Bhasin v Hrynew*^[3] ("**Bhasin**"). Included in this bulletin is a helpful summary of recent leasing cases and their takeaways regarding the duty of good faith for landlords and tenants.

Introduction

The duty of good faith was recognized by the Court in *Bhasin* as a common law doctrine requiring "honest, candid, forthright, or reasonable contractual performance" between two contractual counterparties.^[4] That doctrine has been refined by the Court in *Bhasin* to clarify that "parties generally must perform their contractual duties honestly and reasonably" and must not lie or knowingly mislead the other party.^[5] The Court also confirmed that this duty exists in every contract, without needing to be explicitly mentioned, and cannot be contracted out of.^[6]

Callow expanded the duty of good faith to include a duty to exercise discretionary contractual powers in good faith.^[7] In that case, the Court found that a group of condominium corporations breached their duty of good faith by delaying to inform a maintenance service provider that the condominium corporations would be terminating their contract with the service provider, despite having formed the intention to do so approximately nine months earlier. During this period, the condominium corporations received free supplemental work from the maintenance service provider by deceiving them into believing the contract would be renewed.^[8]

In *Wastech*, the Supreme Court further outlined the parameters of the duty of good faith in finding that an unreasonable exercise of discretionary contractual powers will breach the duty of good faith where the exercise of such discretion is arbitrary or capricious or is unconnected to the purpose for which the discretion was granted.^[9] A finding that the duty has been breached will not be determined by what a Court thinks is "fair," but on "what is reasonable according to the parties' own bargain."^[10] In *Wastech*, the Court held that when the parties to the contract in question agreed on the inclusion of a discretionary power allowing one party to reallocate waste from one facility to another, the party having such discretionary power was entitled to exercise

it regardless of whether it financially disadvantaged the other party, because that power was connected to the purpose of the discretion, being in this case the maximizing of efficiency, the preservation of site capacity and cost-effectiveness.^[11]

Case Law Update

Following *Bhasin*, *Callow*, and *Wastech*, various lower common-law courts across Canada have been applying the duty of good faith to different landlord-tenant situations in commercial leases. The following table summarizes key takeaways in those cases regarding the duty of good faith, the brief facts of the case and the Court’s ultimate ruling.

Case	Facts	Ruling	Takeaway on Good Faith
<i>Amazon Alaska Development Partnership v ARC Digital Canada Corp.</i> 2023 BCCA 34, leave to appeal to SCC requested	The Landlord sent the Tenant a Lease Modification Agreement (“LMA”) to sign. The Tenant signed the LMA, but the Landlord only signed the LMA once the Tenant fell into a breach under the LMA.	The Landlord was found to have breached the duty of good faith and was ordered to pay damages according to what was owed under the LMA.	A breach of the duty of good faith can be found for misleading the landlord/tenant counterparty into thinking the tenant/landlord will sign and perform the agreement proposed by the tenant/landlord.
<i>1164803 Ltd. v Visa Solutions Limited</i> 2022 BCSC 273	The Landlord terminated a month-to-month lease with the Tenant, citing various breaches of the Lease. The Tenant denied any breaches and argued that the termination was improper due to unproven allegations.	The Landlord’s termination of the Lease was upheld.	Honest but unproven allegations of lease breaches in a landlord’s termination notice will not necessarily violate the duty of good faith.
<i>CNOOC Petroleum North America ULC v 801 Seventh Inc.</i> 2021 ABQB 81	The Tenant alleged a breach of the duty of good faith and requested to view the Landlord’s confidential information during the proceedings.	The Tenant merely alleging a breach of the duty of good faith was not a valid reason for the Court to order the Landlord’s disclosure of their mortgage, financial, tax or accounting documents.	The Court may find a breach of the duty of good faith that requires full disclosure, but the mere allegation of a breach cannot be used to justify a fishing expedition for the other party’s confidential documents or sensitive information.
<i>8573123 Canada Inc. (Elias Restaurant) v Keele Sheppard Plaza Inc.</i> 2021 ONCA 371	The Tenant sought to renew the Lease for their Black-owned restaurant that catered to the Afro-Caribbean community. The Landlord rejected the Tenant’s attempts to renew for substantively higher price based on the Landlord’s purported claim that it wanted to replace the Tenant with a more “suitable” business.	The Court allowed the Lease to be reinstated, by granting the Tenant relief from forfeiture.	A refusal to renew a lease based on underlying prejudice or racism, can give rise to a breach of the duty of good faith.

<p>2505243 Ontario Limited (By Peter and Paul.com) v Princes Gates Hotel Limited Partnership 2022 ONCA 859, leave to appeal to SCC refused, 40506 (4 May 2023)</p>	<p>The Landlord informed the Tenant that they wished to preserve its Lease while privately negotiating for a new tenant. The Landlord terminated the lease without notice to the Tenant in order to enter into a lease agreement with a new tenant.</p>	<p>The Court found a breach of the duty and awarded the Tenant damages of more than \$8 million (as the original finding of the Landlord's breach of contract was not appealed).</p>	<p>Examples of actions that may be "dishonest or misleading" and therefore a breach of the duty of good faith include:</p> <ul style="list-style-type: none"> · negotiating with a new tenant without disclosing such negotiations to the current tenant and claiming it was "business as usual" · using the tenant's silence to one instance of correspondence as justification for termination
<p>2059008 Ontario Ltd. v C.M. Weicker 2022 ONSC 1637</p>	<p>Nearing the end of a 10-year Lease, the Landlord realized they had been undercharging Tenant based on square footage of the leased premises. The Landlord waited to disclose this information until renewal negotiations. The Landlord agreed to not seek back rent if Tenant agreed to a renewal Lease that was substantially different from the original. The Tenant ultimately decided not to renew the Lease, and as a result, the Landlord initiated legal action seeking payment for past rent. In response, the Tenant alleged that the Landlord had acted in bad faith by leveraging the potential renewal against legal action. In opposition, the Landlord claimed that the Tenant acted in bad faith by choosing not to renew the Lease.</p>	<p>The Landlord was both statutorily barred under the applicable limitations period and based on the prior assertions, prevented ("estopped") from making any claims for rent arrears. Therefore, Tenant was not liable for any breaches regarding the refusal to pay back rent.</p>	<p>Withholding information pertinent to the Lease from the opposing party that affects the parties' upcoming negotiations may be seen as dishonest or misleading. A discretionary contractual power cannot be used as a threat to force the other party into an agreement.</p>

Conclusion

These cases illustrate that landlords and tenants in commercial leases are best served by honestly communicating with the other party and properly following the provisions of the Lease. One should resist the urge to act or react out of spite. Even in situations where more profitable leasing opportunities may arise, one should avoid misleading the other party.

For a more detailed review of questions and concerns pertaining to the duty of good faith in commercial leasing, please reach out to one of the members of McMillan's Commercial Leasing team.

[1] 2020 SCC 45 [Callow].

[2] 2021 SCC 7 [Wastech].

[3] 2014 SCC 71 [Bhasin].

[4] *Ibid* at para 66.

[5] *Ibid* at para 73.

[6] *Ibid* at para 74.

[7] *Callow* at para 33.

[8] *Ibid* at para 5.

[9] *Wastech* at para 4.

[10] *Callow* at para 71.

[11] *Callow* at para 100.

by [Mervyn Allen](#), [Ximena Pinilla](#), [Jacob Stucken](#), [Josh Sheppard](#) (Summer Student)

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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