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COMMERCIAL LEASES DURING THE COVID-19 LOCKDOWN: WHERE ARE WE HEADED?

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A year after the first province-wide shutdown, courts continue to hear disputes between commercial landlords and tenants over unpaid rent. As a result of stay-at-home orders and increased restrictions on non-essential business activity, many commercial tenants have struggled to pay their lease obligations. Questions have arisen about what landlords and tenants are permitted to do in these circumstances, particularly whether landlords can terminate leases and evict tenants for non-payment of rent.

Along with other measures to protect the Canadian economy, most provincial governments have enacted legislation preventing commercial landlords from terminating a commercial lease for non-payment of rent. Meanwhile, the Federal government has passed a series of bills intended to supplement income for commercial landlords and provide protection for commercial tenants.

Ontario courts have also seen fit to grant some commercial tenants "relief from forfeiture" by reinstating their leases after they were terminated. Such decisions appear to indicate that protections may exist in common law once governmental relief efforts have ended. While landlords appear to have fewer options at this time, recent case-law does provide landlords with important tools to prepare for potential future litigation with tenants.

Federal Rent Relief Legislation

Following the onset of the COVID-19 pandemic, the federal government passed a range of legislation to protect businesses and the economy.

In May 2020, the federal government introduced the Canada Emergency Commercial Rent Assistance ("**CECRA**") program to assist commercial tenants with rent. CECRA provided forgivable loans to eligible commercial landlords who agreed to lower or forego the rent of impacted small business tenants from April through to September 2020. These loans covered 50% of gross rent owing and, in exchange, landlords were required to agree to reduce rent by 25% (i.e. forgo 25% of the rent), with the tenant remaining responsible for the final 25%.

In September 2020, CECRA was replaced with the Canada Emergency Rent Subsidy ("**CERS**"), a rent subsidy program for commercial tenants that does not require landlord participation. Under CERS, most commercial tenants experiencing a drop in revenue of up to 70% in a prescribed period as compared to another prescribed period were eligible for a subsidy to cover up to 65% of their per location rental costs up to a maximum of $75,000.00, with an aggregate maximum cap across all locations in Canada of $300,000.00. An additional subsidy of 25% of such per location costs (with no maximum aggregate cap) is also available where a tenant is required to shut down completely as a result of pandemic-related governmental restrictions. The qualifying periods run from September 27, 2020 up to June 5, 2021. According to the 2021 Federal Budget, CERS will now be available until at least September 25, 2021.

Provincial Initiatives

Ontario has also passed legislation to protect commercial tenants.

Ontario's Commercial Tenancies Act[1] (the "**Act**") outlines the rights and obligations of commercial landlords and tenants. The Act provides landlords with certain remedies, including termination, in the case of tenants' non-payment of rent.

Since the onset of the COVID-19 pandemic, the Act has been amended by three consecutive bills, each bill repealing the previous changes:

- *Bill 192, Protecting Small Business Act, 2020*[2] ("**PSBA**") came into effect on June 18, 2020. It introduced protections for commercial tenants whose landlords declined to apply for the federal CECRA relief program. The PBSA prohibited courts from ordering evictions for non-payment of rent and suspended landlords' right of re-entry for non-payment of rent during a "non-enforcement period" which covered May 1, 2020 to September 1, 2020. The PBSA was intended to incentivize landlords to apply for rental relief under CECRA on behalf of their tenants.
- *Bill 204, Helping Tenants and Small Business Act*[3] ("**HTSBA**") came into force on October 1, 2020 and continued the protections offered under the PSBA. The HTSBA covered the period of September 1, 2020 to October 30, 2020.
- *Bill 229, Protect, Support and Recover from COVID-19 Act, 2020*[4] ("**PSRCA**") came into force on December 8, 2020 and provides similar protections to its predecessors, with retroactive effect to October 31, 2020. In addition, the government enacted O. Reg. 763/20: *Non-Enforcement Period – Prescribed Tenancies*, a regulation under the PSRCA (the "**Regulation**"). The Regulation is effective as of December 17, 2020 and introduces a new moratorium tied to the CERS. The government has yet to announce a firm end date for the PSRCA.

While the PSRCA may protect certain commercial tenants from eviction and distress, nothing in the legislation prevents landlords from suing to recover rent arrears, which remain payable notwithstanding any moratorium on eviction and distress. Absent an express agreement providing for rent-relief or an applicable force majeure clause in its lease, a commercial tenant who stops paying rent has breached its lease. Although landlords are prohibited from evicting defaulting tenants during the non-enforcement period, tenants can be evicted once the PSRCA expires.

When a landlord terminates a tenancy for non-payment of rent, it should anticipate, however, that the tenant may apply to the court for relief from forfeiture.

Relief from Forfeiture

Relief from forfeiture is an equitable remedy that gives the court broad power to set aside any landlord termination of the lease and to reinstate the evicted tenant to the leased premises. Relief may be offered if, for example, the tenant's default was minor or has been cured, if the court concludes that there is an ulterior motive behind the termination, or if it is determined that hardship to the landlord is minimal. In deciding whether to grant a commercial tenant relief from forfeiture, a court will consider:

- the conduct of the applicant and gravity of the breaches;
- whether the object of the right of forfeiture in the lease was essentially to secure the payment of money; and
- the disparity or disproportion between the value of the property forfeited and the damage caused by the breach.[5]

Generally, courts have been sympathetic to commercial tenants' applications for relief from forfeiture, absent egregious conduct which militates against such relief. Some recent case law appears to demonstrate that courts are also willing to exercise their equitable discretion in favor of such relief in the context of pandemic-related defaults.

The Second Cup Ltd. v. 2410077 Ontario Ltd ("Second Cup")

In February 2020, Second Cup signed a lease amendment extending its lease for an additional ten years. The amendment required Second Cup to pay a non-refundable deposit of $30,000. Second Cup paid the deposit.

When the COVID-19 pandemic hit in March, Second Cup was forced to suspend operations and became concerned that it would be unable to pay April rent. The landlord advised Second Cup that it could pay April rent in two installments, on April 1st and April 15th.

Although Second Cup paid nearly 75% of its rent on April 1st, the landlord issued a notice of default two days

later. A few weeks later, the landlord demanded that Second Cup pay both rent arrears and rent for the entire month of May on May 1st. When Second Cup failed to make that payment, the landlord changed the locks. On May 4th, the landlord sent a notice of termination relying on the April 3rd notice of default and rejected Second Cup's offer to immediately pay all outstanding rent.

At that point, Second Cup applied to the Court for a declaration that the lease was unlawfully terminated. In the alternative, Second Cup sought relief from forfeiture. The Court declared that the termination was unlawful (because of the landlord's initial waiver of payment of full rent on April 1st), reinstated the lease, and restored Second Cup's rights as they existed prior to the landlord's notices and termination of the lease.

Although the Court found the termination to be unlawful and therefore relief from forfeiture to be unnecessary, the Court nonetheless considered whether the tenant was entitled to such relief. In doing so, the Court set out additional criteria to be considered where the alleged default is based on the non-payment of rent:

- whether the tenant acted honestly and in good faith;
- whether there is an outright refusal to pay rent;
- the extent of the rental arrears; and
- whether the landlord has suffered serious loss due to the delay in paying rent.[6]

The Court held that the tenant was entitled to relief from forfeiture. The Court found the tenant's rental arrears amounting to 25% of the rent to be insignificant "in light of what was happening in the world as a result of the COVID-19 pandemic", particularly as the tenant did not have a history of default.[7] Further, the tenant's letter to the landlord indicating that it would not be able to pay its April rent on the first of the month was not an outright refusal to pay rent. Instead, the Court found this was a reasonable and transparent communication made by a responsible commercial tenant. Conversely, the Court found the landlord's demand to be unreasonable, since it focused on non-payment of past and future rent. Finally, the Court found that the commercial landlord had not submitted any evidence that it would suffer actual prejudice as a result of not having been paid the balance of April and May's rent under the lease.

The Court noted that while a landlord's motivation for termination is not relevant, a landlord's conduct may be relevant when deciding whether to grant relief from forfeiture. Considering the landlord's conduct, the Court found that it sought to take advantage of the tenant by keeping the deposit and capitalizing on an opportunity to terminate the lease and enter into a new lease with a new commercial tenant. The landlord had not only rejected the tenant's offer to bring the lease into good standing, but immediately thereafter signed a lease with a competitor business on terms that granted the competitor a significant rent-free period. Although the landlord argued it was simply trying to mitigate its damages, the Court found the rent-free period was

evidence that Second Cup's failure to pay 25% of the rent did not significantly harm or prejudice the landlord.

At the hearing, the tenant confirmed that it remained ready and willing to pay all outstanding arrears for April and May, as well as the full amount for June. The Court held that even if the termination had been lawful, which it was not, the tenant would be entitled to relief from forfeiture as the balancing of equities were in its favor.

2487261 Ont. Corporation v. 2612123 Ont. Inc.

In this case the tenant, Symphony Banquet Hall ("**SBH**"), failed to pay rent in full between March 1, 2020 and November 1, 2020. On October 19, 2020, the landlord locked SBH out, even though a non-enforcement period was in effect under the HTSBA.

At the hearing, SBH argued that it had a rent abatement agreement with its landlord in which SBH (a) was not required to pay March rent until it was able to reopen, and (b) would only pay 25% rent for April to September. In finding that SBH was entitled to relief from forfeiture, the Court considered the same seven factors considered in *Second Cup*.[8]

The Court found that the landlord acted unreasonably and in bad faith by "lulling" SBH into thinking that it had applied for the CECRA program by offering a rent reduction of 75% and by having the tenant sign a blank CECRA application.

The Court further found that SBH had acted in good faith by making the payments it did during the pandemic. Although the tenant was in arrears for October and November rent, it was only in default for three weeks before being locked out. The Court found that there would be little damage to the landlord so long as SBH made payments to bring it into good standing under the lease.

***Ontario International College Inc. v. Consumers Road Investments Inc* ("Consumers Road")**

In contrast with the foregoing cases, in Consumers Road, the Court dismissed an application for relief from forfeiture after finding that the tenant-applicant had acted unreasonably.

The landlord terminated the lease in the spring of 2020 after the tenant had repeatedly failed to pay rent. The tenant subsequently issued an application for relief. The Court issued orders setting payment schedules and adjourning the application; however, the tenant failed to make those court-ordered payments.

In determining whether the tenant should be granted relief from forfeiture, the Court considered the above factors and found that all three favored the landlord.

First, the Court found that the tenant's conduct was unreasonable because it had repeatedly missed payments,

many of which were due before the onset of the pandemic. The tenant had also failed to comply with court orders and repeatedly broke promises to pay. The Court found the tenant's breach to be significant as both the amount owing and the length of the breach were substantial, and the tenant refused to provide financial information to prove that it would be able to make future payments.

Second, the Court considered whether the object of the right of forfeiture was merely to secure payment of money. It was not. The Court found that the landlord provided the tenants many opportunities to bring the lease into good standing, including during the litigation. Additionally, the landlord had taken steps to mitigate its losses by entering into a lease with another entity for a portion of the premises, but was prevented from complying with that lease due to the current application. In other words, the landlord was exercising its right of forfeiture to comply with the new lease.

Finally, the Court considered the proportionality factor. Although the tenant claimed to have invested approximately $1 million in improvements, it failed to prove expenses of more than $200,000, and much of that was for equipment and other items the tenants could remove. On the other hand, the tenant owed a combined amount of nearly $1 million.

The Court found that, on the whole, the tenant failed to meet the test for relief from forfeiture. The Court further found that PBSA protection did not apply because the landlord had exercised its right to re-entry in April 2020, which was well before the non-enforcement period began.

Key Takeaways

- Tenants intending to argue an entitlement to rent relief during a pandemic lockdown must, at the very least, give advance notice to the landlord of its intention not to pay rent during the lockdown.
- A tenant's expressed desire to enter into a rent abatement or deferral agreement during the pandemic may weigh in its favor because the expressions contradict an outright refusal to pay rent.
- In deciding whether to grant relief from forfeiture, courts may consider a number of factors, including the length of the tenancy, the tenant's history of defaults, and the tenant's ability to bring the lease into good standing. Where special circumstances are at play, those factors may weigh more heavily in favor of the tenant.
- Landlords should not attempt to re-enter the premises or terminate a lease during the non-enforcement period. Landlords should, however, continue to clearly communicate any new defaults under the lease and/or rent obligations to their tenants.
- If a tenant has outstanding arrears and remains unable to pay after the non-enforcement period expires, the landlord should provide notice in the form required under either the lease or the Act prior to exercising its right of re-entry or termination. Courts will consider the landlord's conduct if a tenant

subsequently brings an application for relief from forfeiture.

[1] R.S.O. 1990, c. L.7.
[2] S.O. 2020, c. 10. Temporarily amended the Commercial Tenancies Act, R.S.O. 1990, c. L.7.
[3] *2020*, S.O. 2020, c. 23
[4] S.O. 2020, c. 36.
[5] *Jungle Lion Management Inc. v. London Life Insurance Company*, 2019 ONSC 780 at para 34.
[6] *The Second Cup Ltd. v. 2410077 Ontario Ltd.*, 2020 ONSC 3684 at para 59.
[7] *Ibid* at para 60.
[8] *2487261 Ont. Corporation v. 2612123 Ont. Inc.*, 2021 ONSC 336 at para 50.

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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.