Commercial Litigation

Landlords Must Act in Good Faith, Or Pay the Price

In May 2023, the Supreme Court of Canada declined leave to appeal from the judgment of the Court of Appeal for Ontario in *2505243 Ontario Limited (ByPeterandPaul.com) v. Princes Gates Hotel Limited Partnership*, 2022 ONCA 859 ("*Princes Gates*").

The Court of Appeal's decision is a stark reminder for landlords to carry out their contractual duties honestly and reasonably.

Background

The appellant, Princes Gates GP Inc. ("PG"), owns and operates Hotel X in Toronto. PG leased two restaurant spaces in Hotel X to 2505232 Ontario Limited o/a ByPeterandPaul.com ("250"). The landlord-tenant relationship was turbulent from the outset. Since opening, the hotel had a low occupancy rate which put stress on both landlord and tenant. In November 2019, PG changed the way it paid event deposits to 250, which had a serious impact on 250's cash flow.

In February 2020, prior to the Covid-19 pandemic, 250 sought to begin negotiations to dissolve their leases and food and beverage services agreement (the "Agreements"). PG responded to this request by emphasizing that it preferred 250 to remain as a food operator and tenant in the hotel, but it was open to discussions to dissolve the Agreements if insisted (the "February Letter").

In March 2020, the Covid-19 pandemic afflicted the Province of Ontario. PG unilaterally shut down Hotel X without consulting 250, while insisting that rent be paid during the closure. In April 2020, PG began discussions with a new food and beverage provider, Harlo, to replace 250, which continued in secrecy and resulted in a letter of intent being signed with Harlo. Execution of the corollary agreements with Harlo was made conditional on the dissolution of the Agreements with 250. While this was ongoing, PG withheld deposits owing to 250 and refused to assist with an application for available government relief. In July 2020, PG terminated 250's agreements for failure to pay rent. In response to a claim by 250 for breach of contract as described in greater detail below, PG commenced a bankruptcy application against 250 which placed 250 into bankruptcy.

Trial Decision

250 sued PG for breach of contract. The trial judge held in favour of 250, finding that PG's termination of the agreements was done in bad faith as:

1. PG permitted 250 to believe that it was "business as usual" while negotiating with another tenant with a clear intention to replace 250;
2. PG terminated the agreements without notice which had drastic and foreseeable consequences, including compensation for 250's 200 employees who were working at Hotel X at the time; and
3. PG's reliance on 250's lack of response to the February Letter to justify its actions was disingenuous.

The trial judge ordered PG to pay over $7 million in reliance damages, less just over $700,000 in damages owed by 250 to PG. The trial judge also ordered PG to pay over $2 million in employee compensation damages to be held in trust and used to satisfy employee claims, which were not to be made available to other creditors in 250's bankruptcy.

Court of Appeal

PG advanced seven issues on appeal, none of which were successful.

Issue #1 – Termination of the Lease

The first issue was whether the trial judge erred in finding that PG had improperly terminated 250's lease.

The Court of Appeal rejected this ground of appeal, finding no fault with the trial judge's analysis that PG took a high-handed approach and wrongfully withheld deposits and HST owed to 250 and used the unpaid deposits to demand concessions it was not entitled to under the Agreements. At bottom, the Court of Appeal agreed that PG's actions contributed to 250's inability to pay rent.

Issue #2 – Refusal to Assist with CECRA Application

The second issue was whether it was unreasonable for PG to refuse to assist 250 with a potential application for relief under the Canada Emergency Commercial Rent Assistance Program ("CECRA"). CECRA would have resulted in PG receiving 75% of the required rent. On appeal, PG took the position that 250 was not eligible for CECRA as its income exceeded the threshold.

The Court of Appeal rejected this ground of appeal and was critical of PG's related conduct. In the middle of the pandemic, PG insisted that 250 obtain an independent CPA's opinion about its revenue, when 250 had a T2 filing for 2019 demonstrating revenue within CECRA's threshold. The Court of Appeal held that by refusing to support a CECRA application, PG contributed to 250's failure to pay rent, and endorsed the trial judge's inference that PG did not want to assist 250 since it had already decided it wanted to dissolve the Agreements and move forward with Harlo as a new provider.

Issue #3 – Damages Prior to Non-Enforcement Period

The third issue was whether 250 suffered damages as a result of the termination of the Agreements before the end of the applicable statutory non-enforcement period under the Commercial Tenancies Act.

The Court of Appeal declined to address this argument as it only involved expectation damages, which the trial judge opted not to award in favour of reliance damages.

Issue #4 – Bad Faith

The fourth issue was whether the trial judge erred in making a finding of bad faith. PG argued that it did not mislead 250 about its continuing obligation to pay rent and consistently insisted that 250 was required to make monthly rental payments.

The Court of Appeal relied on the 2020 Supreme Court of Canada decision in *Callow Inc. v. Zollinger*, in finding that there was no error in the trial judge's finding that PG misrepresented its intention to continue the Agreements. The trial judge found PG knew that 250 intended to stay on and continue with its contract, but, despite this, it continued with serious negotiations with Harlo which was kept entirely secret from 250. The trial judge's finding of a breach of the duty of good faith in contract by way of misleading by inaction was upheld.

Issue #5 - Damages

The fifth issue was whether 250 was in such financial failure that it suffered no damages, even if PG wrongfully terminated the Agreements.

The Court of Appeal rejected this argument as the trial judge awarded reliance damages, not expectation damages. The trial judge examined the lost capital which 250 expended in reliance on the performance of its contract and found this analysis to be a more rational and reliable manner of assessing damages than by guessing what the future profits of 250 could be, particularly in light of an unpredictable variable such as the pandemic.

The Court of Appeal provided a reminder that where an injured party cannot prove expectation damages or loss of profits, or where the contract has been unprofitable, the injured party may elect to claim reliance damages which recognize that the injured party changed its position in reliance on the contract. In this scenario, the court tries to put the injured party in the position it would have been in had it not entered into the contract from the outset, i.e., the reliance damages amount to wasted expenditures that the injured party incurred in reliance on the contract but would not have incurred had it known that the contract would be or had been breached.

Issue #6 – Damages for Future Claims by 250's Former Employees

The sixth issue was whether the trial judge erred in awarding over $2 million in damages for claims to be potentially and consequentially made against 250 by its former employees, who lost their jobs when PG terminated the Agreements.

The Court of Appeal rejected this ground of appeal without a lot of comment, other than stating that these damages formed part of the overall compensatory damages claimed and all the trial judge did was set up a potential process for considering the claims, together with a cap on the potential total award.

Issue #7 – Mistrial

The last issue on appeal was whether the trial judge erred by not declaring a mistrial when it became known that three of 250's witnesses had been watching the trial for six days on Zoom.

The Court of Appeal rejected this ground for appeal and held that the trial judge was in the best position to make the call not to declare a mistrial. Importantly, neither party had sought an order excluding witnesses.

Takeaways

This decision is another evolution in the jurisprudence on the duty of good faith in the performance of contracts and should be a stark reminder to parties to act fairly and in good faith. In light of the Supreme Court's refusal to grant leave, it is important that parties to a contract, including leases, are aware of the Court of Appeal's decision.

In Princes Gates, the landlord tried to have its cake and eat it too by, 1) negotiating with a new tenant/food and beverage provider in secrecy, 2) all while attempting to demonstrate to the tenant that it was "business as usual", and 3) contributing to the tenant's bleak financial situation and inability to pay rent. Those "tactics" have left the landlord with a multi-million-dollar judgment that it could have avoided if it acted honestly and reasonably with its tenant.

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