**Commercial Real Estate and COVID-19: Canadian Market Impacts**

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The global COVID-19 outbreak has and will continue to affect all aspects and sectors of the Canadian commercial real estate industry. In this post, we focus on the impacts on landlords and tenants under commercial leases.

**Commercial Leases**

The starting point for any landlord or tenant considering their rights and obligations in the context of recent business interruptions and premises closures is “what does the lease say?”. Careful attention and review should be given to the express terms of the lease and specifically to the following types of provisions:

Obligation to pay rent: Generally, the tenant’s obligation to pay rent is absolute and without any express right to suspend, abate, withhold or set-off, but it’s worth confirming whether such obligation is conditional on the tenant having access to its premises or whether any other express rights to abatement would apply in these circumstances.

Force majeure: Commercial leases generally include a “force majeure” or “unavoidable delay” provision that addresses uncontrollable and/or unforeseeable events. In Quebec, even if the lease does not contain such a provision, the force majeure provisions of the Civil Code of Quebec will apply. The terms of such lease provisions should be reviewed to confirm whether they cover “health emergencies”, “epidemics”, “pandemics”, “government orders” or the like. While it is possible that a force majeure clause may offer relief from the requirement to perform certain non-financial obligations, most will not relieve a tenant from its financial obligations under the lease including the payment of rent.

Health emergency and compliance with laws: Landlords should be mindful of the fact that many newer leases (particularly those entered into following the SARS outbreak) contain express provisions giving them specific rights in health emergencies. Furthermore, almost all commercial leases include a requirement that the tenant, and in some cases the landlord, comply with all laws and governmental orders – which, in a situation such as we are currently experiencing, may compel the tenant to suspend its operations and require the landlord to shut down the building or centre.

Continuous operation: Retail leases often prohibit the tenant from “going dark”. With recent government orders in several provinces requiring non-essential businesses to close temporarily, tenants who are required to close may wonder whether they will be in breach of their continuous operation covenant. In these circumstances, tenants may be relieved from observing such provisions on the basis of, among other things, provisions regarding force majeure and provisions requiring compliance with laws. In any event, landlords and tenants should consider whether and to what extent they are obliged to have personnel attend leased premises, or to allow the other party to do so, to maintain safety and security through periods of decreed closure.

In light of the significant disruption and negative impact on tenants’ business operations caused by the COVID-19 outbreak, many tenants may be looking for some type of rent relief or even the ability to terminate their lease. Where the express terms of the lease do not afford such rights to the tenant, the following are some common law and statutory principles that tenants may look to:

Relief from forfeiture: Where a landlord has elected to terminate a lease as a result of a default by the tenant, the tenant may apply to the court for relief from forfeiture, which is a discretionary remedy available under both statute (for example, Ontario’s Commercial Tenancies Act) and at law which allows the court to essentially undo the termination and allow the tenant to cure the default where the court, given the conduct of the parties and the surrounding circumstances, considers it just and reasonable to do so. The courts have generally taken a broad and generous view of what is just and reasonable, particularly when the defaults are capable of cure (such as monetary defaults) and the tenant shows some contrition and willingness not to commit the breach again. This is especially the case when the lease involves an active business, where the termination of the lease would put the tenant out of business, result in loss of good will and/or cause disruption to the employment of staff. In considering the tenant’s request, the court will consider three factors: (i) the tenant’s conduct and the seriousness of the breach or breaches; (ii) whether the dispute has to do with the payment of money as opposed to some other type of breach (in the sense that relief from forfeiture will much more readily be granted where the issue is strictly monetary); and (iii) the disparity between the value of the property in question and the damage caused by the breach. Generally, when relief from forfeiture is granted, before the lease is reinstated the court will order the tenant to put the lease back into good standing (which would include paying all rental arrears) and to pay the landlord for the costs incurred in the eviction and in the court proceedings involved in the relief from forfeiture. In Quebec, the closest equivalent to relief from forfeiture is article 1883 of the Civil Code of Quebec which allows a tenant to avoid resiliation of a lease by paying the rent, plus interest and costs, but only if resiliation has to be declared by a court and it does so before judgement. Most commercial leases allow the landlord to resililiate a lease following a default as of right and without going through the courts, however, which effectively precludes the application of this article.

Frustration: The common law doctrine of frustration arises where an unforeseeable event renders performance of the contractual obligations impossible or that significantly frustrates the original purpose of the contract. A tenant may be tempted to turn to this doctrine where, for example, the tenant is unable to access its premises as a result of closure by the landlord. It should be noted that the threshold for proving frustration is high and may be affected by applicability of any express force majeure provision. Furthermore, the result of a successful claim for frustration is not merely suspension the tenant’s obligation to pay rent, but termination of the lease – which may not be the desired outcome for the tenant.

Breach of landlord’s covenant of quiet enjoyment or derogation from grant: Where a tenant is deprived of access to its premises by the landlord, the tenant may wish to assert that this constitutes a breach of the landlord’s covenant of quiet enjoyment (which provides that the tenant’s use of its premises shall be free from unlawful and unreasonable interference by the landlord), or alternatively that this constitutes a derogation from grant (which arises where there has been an act by the landlord which renders the premises substantially less fit for the purpose for which they were let). It seems unlikely that a tenant could successfully rely on such claims in order to terminate a lease where the temporary restriction/deprivation of access to the premises is the result of the landlord simply following a government closure recommendation or order. Unlike the doctrine of frustration, however, remedies short of termination, such as abatement of rent, are theoretically available should a claim for breach of the covenant for quiet enjoyment or derogation from grant be successfully made. Landlords should keep this in mind when deciding whether and how to impose restrictions on tenants’ access to their premises.

While these principles may ultimately provide some recourse or relief to tenants facing the significant disruption and negative impact caused by the COVID-19 outbreak, both tenants and landlords will ideally want to avoid the time, cost and uncertainty associated with such legal proceedings. Accordingly, dialogue and negotiated arrangements between landlords and tenants, whether in the form of rent deferral, abatement or ultimately rent relief, may offer the most expedient outcomes for both parties. Governmental and societal pressures and the uncertainty of the current situation will undoubtedly create incentives for landlords and tenants to work together to find mutually satisfactory solutions to these problems.

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